RECENT DEVELOPMENTS

TAXATION—CAPITAL GAINS TREATMENT DENIED LIQUIDATION-REINCORPORATION TRANSACTION—*Moffatt v. Commissioner, 363 F.2d 262 (9th Cir. 1966)*—The revenue laws make a sharp distinction in the tax treatment of liquidating distributions as compared with dividends. The transactions in *Moffatt v. Commissioner*[1] illustrate the occurrence of a liquidation-reincorporation transaction in which distributions were erroneously accorded by the shareholders the favorable status of distributions in liquidation.

Moffatt & Nichol, Inc. was primarily engaged in consulting engineering, and also participated in various joint ventures. The firm prospered greatly in the decade following its inception in 1947, but only one dividend was paid (30,000 dollars in 1955) during the company's existence. Throughout this period the stock was owned by taxpayers Moffatt (45 percent), Nichol (45 percent), and Murray (10 percent). While these shareholders were the firm's most important employees, there were more than sixty other employees of whom approximately one-third were of professional standing.

An outside accountant was engaged by the firm to analyze the tax problems of both the firm and its shareholders. The accountant's proposal was to liquidate the firm or to transfer assets to a new corporation with a subsequent liquidation of Moffatt & Nichol. By following either proposal, the shareholders could obtain capital gain treatment of accumulated earnings, provide capital gains against which the substantial non-business bad debt losses of both Moffatt and Nichol could be offset,[2] and provide a new corporate entity which would not risk joint ventures so as to be a more attractive investment for Bobisch, an employee of Moffatt & Nichol, Inc.

A new entity, Moffatt & Nichol, Engineers, was incorporated in July of 1957. While the stock was authorized to be issued to Moffatt (40 percent), Nichol (40 percent), Murray (10 percent), and Bobisch (10 percent), Bobisch did not receive any of the stock. From the time Bobisch joined Moffatt & Nichol, Inc., there had been negotiations for his purchase of some of the firm's stock from Moffatt and Nichol. Due to the risk involved in the joint ventures being undertaken by the firm, he refused to pay the book value which was the price being asked. Bobisch terminated his employment and both Moffatt and Nichol bought one-half of his right to receive shares of the new corporation. Thus when the shares were issued, the owners of the old held identical ownership in the new corporation.

All employees of the old corporation were transferred to the new upon its formation. The old corporation's work in process was delegated to the new except certain non-assignable contracts. The new corporation operated on the same premises and used the equipment of the old corporation. The old

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1 363 F.2d 262 (9th Cir. 1966), *affirming*, 42 T.C. 558 (1964), *petition for cert. filed*, 35 U.S.L. Week 3238 (U.S. Nov. 28, 1966) (No. 804).

2 Between the years of 1954 through 1957, Moffatt and Nichol suffered bad debt losses of approximately $47,000. Further such losses were anticipated in later years.

corporation did not execute any new contracts after the formation of Moffatt & Nichol, Engineers. The Tax Court found as a fact that the only reason the old corporation remained in existence was to "phase out" its outstanding Government contracts with its primary activity being to collect accounts receivable.[3]

In December of 1958, the directors of Moffatt & Nichol, Inc. resolved to liquidate the firm. The shareholders received distributions of promissory notes, cash, automobiles and other assets. Much of the old corporation's cash was transferred by the stockholders to the new corporation. The only substantial assets of the old corporation which were not received by the new were land and building plans which were non-operating assets. The new corporation ultimately received approximately 65 percent of the assets of the old corporation.

For the taxable years 1958 and 1959, the taxpayers treated the distributions from the old corporation as long-term capital gain against which capital losses were offset. On the theory that the distributions were "boot" incident to a D reorganization[4] and thereby taxable as dividends under section 356,[5] the court of appeals affirmed the Tax Court's upholding of the Commissioner's assessment of deficiencies.

Shareholders of closely-held corporations sometimes attempt to withdraw, at capital gain rates, assets which represent earnings of the business. This objective is usually pursued by treating the withdrawal as a liquidation which permits the distribution to be taxed at capital gain rates.[6] Since 1924 it has been the law that no gain or loss is recognized by a corporation upon its liquidation and that its shareholders will recognize capital gain or loss measured by the value of the assets received in liquidation less the basis for their shares.[7] In contrast, a dividend is a distribution made by a corporation

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3 Moffatt v. Commissioner, 42 T.C. 558, 566 (1964).

4 Int. Rev. Code of 1954, § 368(a)(1)(D).

5 Int. Rev. Code of 1954, § 356.

6 Int. Rev. Code of 1954, § 331(a). Gain or Loss to Shareholders In Corporate Liquidations.

(a) *General Rule.*—

(1) Complete liquidations.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.

(2) Partial liquidations.—Amounts distributed in partial liquidation of a corporation (as defined in section 346) shall be treated as in part or full payment in exchange for the stock.

The method of accomplishing the distribution usually follows one of two general techniques: (1) The existing corporation liquidates followed by reincorporation of part of the assets by the shareholders. *See, e.g.*, Survaunt v. Commissioner, 162 F.2d 753 (8th Cir. 1947). (2) The existing corporation sells part of its assets to another corporation then one of the corporations liquidates. *See, e.g.*, Lewis v. Commissioner, 176 F.2d 646 (1st Cir. 1949).

7 Revenue Act of 1924, ch. 234, § 201-04, 43 Stat. 254. These same principles are now set forth in §§ 331, 336, and 1001 of the Int. Rev. Code of 1954.

out of its earnings and profits[8] and is subject to taxation at ordinary income rates.[9] Liquidating distributions and dividends, however, are mutually exclusive categories, so the existence of earnings and profits at the time of a liquidation would not affect the taxation of the distribution,[10] if it otherwise qualified as a distribution made in liquidation.

While the "liquidation" concept focuses upon the final termination of the *corporate* enterprise,[11] the "reorganization"[12] concept requires the business enterprise to continue in corporate form and the shareholders of the prior corporation to continue to have substantially the same interest in the new corporation. A reorganization may be defined generally as:

> [A] transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred.[13]

Since the D reorganization is concerned with neither termination nor contraction of the corporate business, retention by shareholders of assets which exceed the value of the surrendered stock is properly classified as "boot" and treated as a dividend to the extent that the assets are not in excess of the shareholders' ratable portion of undistributed profits.[14] The "reincorporation" problem arises when taxpayers seek to combine the capital gain benefits of a liquidation with the reorganization advantages of continued operation of the business in another corporate shell.[15] To permit taxpayers to accomplish this objective would be to permit them to treat a distribution as a capital gain when in fact it is in the nature of a dividend.

In *Moffatt*, the court construed the transactions as being an attempt to improperly treat a dividend as a liquidating distribution. This conclusion was based upon the accountant's memorandum, Moffatt and Nichol's desire to have capital gains against which bad debt losses could be offset and the substantial earned surplus which had not been distributed as dividends.

To prevent what was considered to be a tax avoidance device, the appellate court affirmed the Tax Court's finding of a D reorganization. Superimposed on the express statutory requirements for a D reorganization is the

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[8] *See* Revenue Act of 1916, ch. 463, § 2(a), 39 Stat. 757. Compare Int. Rev. Code of 1939, § 115(a), 53 Stat. 46, as amended, ch. 619 § 186, 56 Stat. 895-96 (1942).

[9] Int. Rev. Code of 1954, § 301.

[10] Hellmich v. Hellman, 276 U.S. 233, 236-37 (1928). This rule is now codified by Int. Rev. Code of 1954, § 331(b).

[11] *See* Treas. Reg. § 1.332-2(c) (1955), Kennemer v. Commissioner, 96 F.2d 177, 178 (5th Cir. 1938).

[12] *See* Treas. Reg. 1.368-1(b) (1955).

[13] Int. Rev. Code of 1939, § 112(g)(1)(C), 53 Stat. 40.

[14] Int. Rev. Code of 1954, § 356(a). For general discussion of "boot" see 3 Mertens, Law of Federal Income Taxation § 20.147 (rev. ed. 1965).

[15] See Bittker & Eustice, Federal Income Taxation Of Corporations And Shareholders 572 (2d Ed. 1966).

factor of business purpose.[16] In reincorporation cases, the business purpose is found if the operations of the old corporation are carried on in whole or in part by the new corporation.[17] A business purpose was found in *Moffatt* because the new corporation continued the operations of the old with the net effect being "merely to change the name of the [old] corporation."[18]

The statutory requirements for a D reorganization are set forth in two sections of the Code which Congress has explicitly linked together.[19] There

[16] Gregory v. Helvering, 293 U.S. 465, 469-70 (1935). This rule is now provided for in the Regulations. Treas. Reg. § 1.368-1(b) (1955) states that the reorganization provisions are concerned with "readjustment of corporate structures . . . required by business exigencies." See also Treas. Reg. §§ 1.368-1(c), 1.368-2(g).

[17] Lewis v. Commissioner, *supra* note 6, at 650. See Survaunt v. Commissioner, *supra* note 6, at 758.

[18] 363 F.2d at 266.

[19] Int. Rev. Code of 1954, Sec. 368. Definitions Relating to Corporate Reorganizations.

(a) *Reorganization.*—

(1) In general.—For purposes of parts I and II and this part, the term "reorganization" means

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(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356;

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Sec. 354. Exchanges Of Stock and Securities in Certain Reorganizations.

(a) *General Rule.*—

(1) In General.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(2) Limitation.—Paragraph (1) shall not apply if—

(A) the principal amount of any such securities received exceeds the principal amount of any such securities surrendered, or

(B) any such securities are received and no such securities are surrendered.

(b) *Exception.*—

(1) In General.—Subsection (a) shall not apply to an exchange in pursuance of a plan of reorganization within the meaning of section 368(a)(1)(D), unless—

(A) the corporation to which the assets are transferred acquires substantially all of the assets of the transferor of such assets; and

(B) the stock, securities, and other properties received by such transferor, as well as the other properties of such transferor, are distributed in pursuance of the plan of reorganization.

are essentially three requirements which must be satisfied in order to qualify as a D reorganization under those sections:[20]

(1) All of the remaining property of the transferor as well as all of the stock, securities, and other property acquired by it pursuant to the exchange must be distributed to its shareholders under a plan of reorganization.

(2) The old corporation, or one or more of its shareholders, is in control of the new corporation.

(3) There must be a transfer by a corporation of substantially all of its assets to another corporation.

It is well settled that it is proper to consider the situation as it existed at the beginning and end of a series of steps to determine whether the liquidation of a corporation was merely a step in a plan of reorganization.[21] In *Moffatt*, the court held that there was a plan of reorganization largely because of the memorandum of the outside accountant, whose plan the court found was adopted by the old corporation.[22]

While there was no formal exchange of stock for stock, courts have recast transactions in a manner which reflects the substance of the transaction;[23] thus the court had no difficulty in finding an exchange of stock for stock. The final step in satisfying the second requirement is finding the control referred to by section 368(a)(1)(D). Because the shareholders of the old corporation were authorized to receive 90 percent of the new corporation's stock, they clearly had "control" as defined by the statute.[24]

The requirement that the transferee receive substantially all of the transferor's assets posed a more significant hurdle to finding a D reorganization. The history of the D reorganization section is useful for appreciating the significance of the "substantially all" requirement.[25] The original purpose of the reorganization section of the Code was to protect taxpayers against the taxation of corporate transactions where no economic gain was actually realized. Under the 1939 Code, the D reorganization did not require that the transferee receive substantially all of the assets of the transferor.[26] The 1954 amendment of that section added the "substantially all' require-

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[20] *Cf.*, dissenting opinion in *Moffatt*. 363 F.2d at 268-69, n.1.

[21] *See, e.g.*, James Armour, Inc., 43 T.C. 295 (1964); David T. Grubbs, 39 T.C. 42 (1962); Joseph C. Gallagher, 39 T.C. 144 (1962).

[22] The dissent did not find a plan of reorganization. *See* 363 F.2d at 268-69, n.1, for statement of circumstances which indicate no plan of reorganization.

[23] *See, e.g.*, Commissioner v. Morgan, 288 F.2d 676 (3d Cir. 1961) (No stock was issued by the transferor corporation in exchange for the transferee's assets.); Reef Corp. ¶ 65-072 P-H Tax Ct. Mem. 65-431 (1965); *aff'd.*, 368 F.2d 125 (1966), petition for cert. filed, 35 U.S.L. Week 3238 (U.S. Jan. 26, 1967) (No. 1005). Ralph C. Wilson. ¶ 46.32 P-H Tax Ct. Mem.

[24] Int. Rev. Code of 1954, § 368(c).

[25] See Paul, Studies in Federal Taxation, Third Series (1940).

[26] Int. Rev. Code of 1939, § 112(g)(1)(D), 53 Stat. 40.

ment for the purpose of withdrawing beneficial reorganization treatment from transactions in which economic gain was realized.[27]

The imposition of that condition appears to permit more possibilities of tax avoidance than previously existed in this area.[28] The ordnary reincorporation case is not likely to involve such a transfer of substantially all of the transferor's assets to the transferee because one of the objectives of such a device is to divert to shareholders a portion of the transferor's assets. Failing to satisfy the "substantially all" requirement, the Commissioner must seek some approach other than a D reorganization to combat the tax avoidance device.

Congress did not intend, however, to permit tax avoidance through the reincorporation technique. Legislative history indicates that the first effort to deal expressly with the reincorporation problem was enacted by the House in 1954.[29] The Senate-House Conference Committee based their decision to reject the proposal on the belief that the possibility of tax avoidance can be prevented by "judicial decision or by regulation within the framework of other provisions of the bill."[30] The courts are unclear as to what weight should be accorded to this statement. While the report cannot be used to make law, it is clear that the deletion of the provision attacking reincorporations was not an expression of policy condoning such tax avoidance techniques.[31]

In the context of this congressional attitude, the court in *Moffatt* took the position that the transferee's receipt of 65 percent of the transferor's assets satisfied the "substantially all" requirement. This conclusion was reached by adopting the view of Rev. Rul. 57-518[32] which proposes that no specific percentage should be controlling in determining what constitutes "substantially all."[33]

While the phrase "substantially all of the assets" or the similar phrase "substantially all of the properties"[34] has been in the revenue law since

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[27] *See, e.g.*, Pridemark, Inc. v. Commissioner, 345 F.2d 35 (4th Cir. 1965), *reversing in part*, 42 T.C. 510 (1964).

[28] *Ibid.*

[29] Int. Rev. Code of 1954, H.R. 8300, 83d Cong., 2d Sess. (1954). The section provided that if the transaction has tax avoidance as a principal purpose, the transfer of more than 50 percent of the assets of the old corporation to a new corporation would result in the taxability of the non-reincorporated assets to the shareholders as dividends.

[30] H. Conference Rep. No. 2543, 83d Cong. 2d Sess., p. 41 (3 U.S.C. Cong. & Adm. News (1954) 5280, 5301).

[31] *See* Pridemark, Inc. v. Commissioner, *supra* note 27, at 41.

[32] 1957-2 Cum. Bull. 253.

[33] Both the Fifth and Tenth Circuits have recently indicated their agreement with a qualitative instead of a quantitative approach to satisfying the "substantially all" requirement. See Reef Corp. v. Commissioner, 368 F.2d 125, 131 (5th Cir. 1966), for case history see *supra* note 23; Babcock v. Phillips, 372 F.2d 240 (10th Cir. 1967).

[34] The definition of a C reorganization has long required the transferee to acquire substantially all of the properties of the transferor. The requirement in the D definition was probably intended to have the same meaning as the C definition even though the

1921,[35] Congress has never codified the term nor have the Treasury Regulations set forth a definition. The case law suggests that the transferee must acquire at least 80 percent of the transferor's assets in order to satisfy the "substantially all" requirement.[36] The majority's conclusion that receipt of 65 percent constituted "substantially all" is questionable. The rationale of the court is suggested where the opinion distinguishes prior cases on the ground that they "involved a situation where the *taxpayer* had to show a 'transfer of substantially all' assets to avoid a tax."[37] This indicates that the court recognized the two distinct functions which D reorganizations serve. One function is to permit the occurrence of the kind of transaction described in the statute which could not otherwise take place without imposition of a tax even though no economic gain is realized. The other purpose is to serve as a tool to prevent tax avoidance by use of the liquidation-reincorporation technique. The "substantially all" requirement is meaningful under the first function; under the second it is a handicap.[38] The majority in *Moffatt* undertook to uphold the congressional intent that tax avoidance should not be accomplished by the use of the liquidation-reincorporation device, but the dissent pointed out the difficulty of harmonizing the majority decision with the literal requirements for a D reorganization. The dissenting opinion properly criticized not only the majority's unauthoritative proposition that no specific percentage is controlling in determining "substantially all" but also their considering "good will" without valuing it.[39] Other strained arguments advanced by the Commissioner were that "substantially all" means 50 per-

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latter uses the term "properties" while the D definition uses "assets." *See* Lane, "The Reincorporation Game: Have the Ground Rules Realy Changed?", 77 Harv. L. Rev. 1218, 1249, n.120 (1964). Thus the interpretation of the C definition will be authority for proper application of the D definition.

[35] Revenue Act of 1921, ch. 136, § 202(c)(2), 42 Stat. 230.

[36] *See, e.g.*, Pillar Rock Packing Co. v. Commissioner, 90 F.2d 949 (9th Cir. 1937); The Daily Telegram Co., 34 B.T.A. 101 (1936); Edward H. Russell, 40 T.C. 810 (1963), *aff'd. per curiam*, 345 F.2d 534 (5th Cir. 1965).

[37] 363 F.2d 267 n.1.

> Neither Pillar Rock Packing Co. v. Commissioner of Internal Revenue, 90 F.2d 949 (9th Cir. 1937), nor C. T. Inv. Co. v. Commissioner of Internal Revenue, 88 F.2d 582 (8th Cir. 1937), compel a different result. C. T. Inv. Co., *supra*, is a weak holding at best, for it was an alternative holding and the court noted that the point was not raised or considered before the Tax Courts. Both cases involved a situation where the *taxpayer* had to show a "transfer of substantially all" assets in order to *avoid* tax. Thus, a different standard of construction applies than here, where "capital gain provisions are an exception to the ordinary treatment accorded most income [and must therefore] be strictly construed." Pridemark, Inc. v. Commissioner of Internal Revnue, 345 F.2d 35, 44 (4th Cir. 1965).

[38] *See* text *supra* at notes 30-31.

[39] *See* D. K. MacDonald, 3 T.C. 720 (1944); Northwestern Steel & Iron Corp., 6 B.T.A. 119 (1927).

cent or more[40] and that "substantially all" refers to the firm's operative assets.[41]

The foregoing indicates that the express requirements of the D reorganization may be difficult to satisfy but the majority's treatment of the distributions as being in part "boot" taxable as dividends, accords with the true nature of assets retained by the taxpayers. The firm's operations were in no way affected by the transactions in question; only if the operations of the firm terminates or contracts, or the shareholders interest terminates should the exceptional capital gains treatment for a distribution be given.[42] Thus the distribution received by the taxpayers was in the nature of a dividend and, as the majority held, taxable as such.

Perhaps in recognition of the spurious reasoning required in order to remove the barrier of the "substantially all" requirement when dealing with reincorporation cases,[43] the Commissioner has announced that for purposes of D reorganizations "substantially all" means at least 90 percent of the net assets and at least 70 percent of the gross assets of the old corporation.[44] If this position had been in effect when *Moffatt* was decided, the court could not have found a D reorganization because the new corporation received only 65 percent of the old corporation's assets. An argument can be made that the Rev. Proc. does not affect the *Moffatt* kind of transaction. Because Rev. Proc. 66-34 states that the Commissioner will "ordinarily"[45] find the "substantially all" requirement satisfied if the 70-90 percent tests are fulfilled, it can be argued that those percentages which "ordinarily" apply are not appropriate in a liquidation-reincorporation transaction. This approach is not unreasonable because it furnishes a guide for those seeking reorganization

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[40] *See* note 35 *supra.*

[41] Pillar Rock Packing Co. v. Commissioner, *supra* note 36, at 950.

[42] *See* text accompanying notes 59-63 *infra.*

[43] The Commissioner was beginning to win on the argument that no specific percentage is controlling in determining what constitutes "substantially all." *See* James Armour, Inc., 43 T.C. 295 (1964), citing the Tax Court's decision of *Moffatt.* An additional burying of "substantially all" came in Retail Properties, Inc., 23 CCH Tax Ct. Mem. 1463 (1964). The old corporation had retained a substantial amount of stock, but this did not prevent the court from finding a D reorganization because the stock was classified as a non-operating asset. Thus the "substantially all" requirement for finding a D reorganization was significantly eroded when the Commissioner so requested. *See* Pennell, "Developments and Unanswered Questions in Corporate Reorganization," 42 Taxes 889, 901 (1964).

[44] Revenue Procedure 66-34, 1966-34 Int. Rev. Bull. 22.

> Sec. 3. Operating Rules For Issuing Ruling Letters.—.01 The "substantially all" requirement of sections 354(b)(1)(A), 368 (a)(1)(C) and 368(a)(2)(B)(i) of the Code is satisfied if there is a transfer of assets representing at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets held by the corporation immediately prior to the transfer.

[45] Revenue Procedure 66-34, 1966-34 Int. Rev. Bull. 22 § 2.04.

status from a transaction and preserves for the Commissioner the flexibility needed to police liquidation-reincorporation transactions.

Rev. Proc. 66-34 may have the effect of diminishing the use of the D reorganization as an approach for combatting reincorporations, but there is no reason to suppose that the Service or the courts will look any more favorably upon tax avoidance devices. Thus it is important to closely consider other approaches available to the Commissioner for preventing tax avoidance in this area.

Where the transaction in question lacks economic substance or the new corporate entity is a sham corporation, the court will disregard the formal transaction and treat the distribution as a dividend.[46] Taxpayers are seldom tripped on this approach because they can usually argue that the transactions were motivated by business considerations. Almost any colorable business motive will suffice for preventing the transaction from being labeled a sham.[47]

Another approach used by the Commissioner is the F reorganization.[48] This section has received almost no administrative or judicial attention until recently.[49] Several cases, however, have indicated that it may properly apply to situations which do not involve any significant change in the business of the corporation or the interests of the shareholders.[50] Because of the requirement that there be no more than a "mere change in identity," an F reorganization was not found where only 72-2/3 percent of a new corporation's stock was owned by shareholders of the old corporation.[51] An F reorganization can be found only if the corporate enterprise continues uninterrupted.[52] In a case where the taxpayer owned promissory notes of the new corporation instead of stock, the court refused to find an F reorganization because the taxpayer did not have a proprietary interest in the new corporation.[53] Although in *Moffatt*, the court did not expressly hold that the

[46] *See* Hyman H. Berghash, 43 T.C. 743, 749 (1965) and cases cited therein.

[47] *Id.* at 749-50.

[48] Int. Rev. Code of 1954, § 368(a)(1)(F) defines a reorganization as "a mere change in identity, form, or place of organization, however effected."

[49] *See* Rev. Rul. 57-276, 1957-1 Cum. Bull. 126, Rev. Rul. 58-422, 1958-2 Cum. Bull. 145-46.

[50] *E.g.*, Newmarket Mfg. Co. v. United States, 233 F.2d 493 (1st Cir. 1956), *cert. denied*, 353 U.S. 983 (1957); Ahles Realty Corp. v. Commissioner, 71 F.2d 150 (2d Cir.), *cert. denied*, 293 U.S. 611 (1934). *See* also 3 Mertens, Law of Federal Income Taxation § 20.94 (Rev. ed. 1965).

[51] Joseph C. Gallagher, *supra* note 21, at 162. See Reef Corp., *supra* note 23; Estate of James F. Sutter, 29 T.C. 244, 258 (1957).

[52] Pridemark v. Commissioner, *supra* note 27, at 42.

One author erroneously concluded that the Tax Court decision was correct in finding an F reorganization because there was no change in identity, form or domicile. Pennell, "Developments and Unanswered Questions in Corporate Reorganizations," 42 Taxes 889, 900 (1964). The reversal by the court of appeals was correct because of the one year gap between the old corporation's termination and the new corporation's commencement.

[53] Book Production Industries, Inc., ¶ 65065; P-H Tax Ct. Mem. (1965).

transaction constituted an F reorganization, it can be speculated that such a finding could have been made. The facts relevant to such a determination are that the new corporation was identical to the old corporation in ownership of shares, business which was conducted, place of carrying on business and equipment for conducting the operations. The court found that the net effect of the transaction was "merely to change the name of the corporation."[54] The F reorganization approach, nevertheless, is not an effective means for combatting the liquidation-reincorporation device on a large scale because of the foregoing statutory and judicial limitations.

The next possible approach for the Commissioner is the E[55] reorganization. Neither the Code nor the Regulations define "recapitalization," so presumably a non-technical meaning was intended.[56] In general, the term involves corporate readjustment of existing interests and the rearrangement of the capital structure.[57] The Supreme Court has termed it as being a "reshuffling of a capital structure within the framework of an existing corporation."[58] Rev. Rul. 61-156 holds that the "recapitalization" theory is applicable where one corporation transfers assets to another corporation followed by liquidation of the transferor.[59] This position has been rejected on the ground that the transaction did not take place " within *the framework of an existing corporation.*"[60] This rule is still authoritative, so an E reorganization could not have been found in *Moffatt* due to the fact that the transaction occurred within the framework of two corporations. Because of the requirements for showing an E reorganization, it is useful for attacking only the most blatant liquidation-reincorporation transactions.

The final approach to be considered is the one which presently has the most potential as a weapon for preventing tax avoidance. This approach is to argue that "no liquidation" occurs upon a liquidation-reincorporation transaction. The statute does not define "liquidation" although there is a definition of partial liquidation.[61] While it has been held that the liquidation provision refers only to the steps required by state law to terminate the corporate existence,[62] the better view is to find a liquidation only if the substance of the transaction comports with the underlying purpose of Congress.[63]

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54 363 F.2d at 266.

55 Int. Rev. Code of 1954, Sec. 368(a)(1)(E) defines a reorganization as a "recapitalization."

56 *See* Bazley v. Commissioner, 331 U.S. 737 (1947).

57 3 Mertens, Law of Federal Income Taxation § 20.93 (Rev. ed. 1965).

58 Helvering v. Southwest Consol. Corp., 315 U.S. 194 (1942).

59 1961-2 Cum. Bull. 64.

The "recapitalization" approach would not be applicable where liquidation of a corporation is followed by a reincorporation of the assets. See Mayer, "Ramifications of The Treasury's Liquidation-Reincorporation Doctrine," 25 U. Pitt. L. Rev. 637, 647 (1964).

60 Joseph C. Gallagher, *supra* note 21, at 162. (Emphasis in original.)

61 Int. Rev. Code of 1954, § 346.

62 Hyman H. Berghash, *supra* note 44, at 758-59.

63 Pridemark v. Commissioner, *supra* note 27, at 41.

A distribution in complete liquidation has been analogized to a sale of stock in that the shareholder "surrenders his interest in the corporation and receives money in place thereof."[64] Thus the corporation must have ceased to be a going corporate concern, or if the enterprise is continued in corporate form, the shareholder must have terminated his interest in the concern. Similarly, for a partial liquidation, the distribution must be pursuant to a plan of complete liquidation, or there must be a contraction of the corporate concern.[65] It can be argued that the liquidation provisions are inapplicable where the business is placed into another corporation substantially similar to the old corporation, because under these circumstances the transaction does not resemble a sale. This flexible approach has found judicial acceptance in the *Pridemark* case,[66] and is generally supported by two regulations.[67]

The future success of the "no liquidation" approach is probable because of three circumstances. First, when this approach is invoked by the Commissioner, the courts will be called upon to make substantially the same analysis as they previously have been making in cases where the Commissioner argued that the transaction was a liquidation-reincorporation device. That preliminary analysis is to determine whether the transaction was motivated by business instead of tax avoidance considerations.[68] Second, as the decision in *Moffatt* illustrates, courts are inclined to bend statutory language in order to reach results which are in harmony with the congressional intent to prevent tax avoidance by use of the liquidation-reincorporation technique. Third, if the Rev. Proc. 66-34 definition of "substantially all" will diminish the usefulness of the D reorganization provision for policing liquidation-reincorporation transactions, then courts will probably fortify this weakness by being inclined to permit expanded application of the "no liquidation" approach.

The attractiveness of the liquidation-reincorporation device to shareholders as a method for saving taxes will continue to prompt these transactions. Those which are more clearly tax avoidance motivated may be prevented by treating the transactions as a sham, an E reorganization or an F reorganization. The D reorganization approach was once the most useful means for preventing tax avoidance through a liquidation-reincorporation device, but the 1954 Code amendments as well as the Rev. Proc. 66-34 definition of "substantially all" have had the effect of diminishing its usefulness. The "no liquidation" approach presently offers the greatest potential as a weapon to combat tax avoidance through liquidation-reincorporation transactions.

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[64] *See* H. Conference Rep. No. 2543, 83d Cong. 2d Sess., p. 41 (3 U.S.C. Cong. and Adm. News (1954) 5280, 5301).

[65] *See* Treas. Reg. § 1.368-1(b) (1955).

[66] Pridemark v. Commissioner, *supra* note 27.

[67] *See* Treas. Reg. §§ 1.331-1(c) & 1.301(1) (1955).

[68] *See, e.g.*, Hyman H. Berghash, *supra* note 46, at 749.

PROPERTY—LICENSEE ALLOWED TO SUE FOR INTERFERENCE WITH LICENSE—*Carson v. Hercules Powder Co., 402 S.W.2d 640 (Ark. 1966)*—Plaintiff, Kelsey Carson, a commercial fisherman, had fished in the Bayou Meto, a non-navigable stream, since 1927. Plaintiff alleged that he had, except for one written agreement, oral permission from the riparian owners abutting the stream to fish in the river. He also had an oral agreement with one owner, Watson, allowing him to live on Watson's land for life, and he had so lived since 1951.

Plaintiff claimed that the defendant, Hercules Powder Company, had polluted the stream, killing fish and causing an obnoxious rotten egg odor, making the fish unedible and unsalable. Consequently, plaintiff was unable to fish in the stream from 1961 through 1965. Plaintiff introduced evidence at the trial that the Arkansas Pollution Control Commission had investigated the fish kills in 1959, 1963, and 1964, and that a hearing held in April, 1963, had resulted in a cease and desist order against Hercules. The Commission found that the Hercules Powder Company had discharged large quantities of industrial waste, highly toxic to fish and other life, into the stream, thereby, polluting the stream and creating a public nuisance under Arkansas law.[1] However, the evidence showed that the Commission had been unable to determine the cause of fish kills occurring late in 1963 and in 1964, that possibly they were caused by water runoff from agricultural lands containing chemicals, that the obnoxious odor was caused by decomposition of organic material, and hence Hercules was not responsible for the 1963-64 kills. Further testimony established that Hercules had obeyed the April, 1963, Commission cease and desist order, and that pollution caused by Hercules had ceased. Thereupon, at the conclusion of plaintiff's case, the court found the evidence insufficient to grant an injunction and declined to award any damages.

On appeal, the Supreme Court of Arkansas remanded the proceeding.[2] Bland, J., speaking for the court, stated that the Arkansas Pollution Commission had found the defendant guilty of polluting the stream, and, even though the defendant has since corrected the condition, he is not relieved of liability to the plaintiff for loss of profits and damages to his business. The court then cited with approval the following section from Sedgwick on Damages:[3]

> Any one having an interest in land is liable to suffer injury in [with] respect to his [this] right; and accordingly if his right, however limited it be, is injured, he may recover for [sic] compensation equal to his individual loss. The general rule may be said to be that the extent of the injury to the plaintiff's proprietary right, whatever it may be, furnishes the measure of damages. The owner of a freehold may recover for an injury which permanently depreciates his

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1 Ark. Stat. Ann. § 82-1902-09 (Supp. 1965).

2 Carson v. Hercules Powder Co., 402 S.W.2d 640 (Ark. 1966).

3 1 Sedgwick, Damages § 69 (9th ed. 1939).

> property, while a tenant, or one having only a possessory right may recover for an injury to the use and enjoyment of that right.

The decision in the *Carson* case[4] is unique in that the court allowed a non-riparian owner, one who at best owned no more than an easement to fish in the stream, to recover damages for lost business income caused by an upper riparian owner's pollution of the stream.[5] The court did not hesitate to award damages to the plaintiff, without any inquiry into the basis of his right to maintain the action. From a finding that the plaintiff had oral permission from the riparian owners to fish in the stream, the court reached, without discussion, the result that, "Any one having an interest in land is liable to suffer injury in respect to his right."[6]

The nature of the plaintiff's fishing right could be described as either a license or an easement. Classification as one or the other, while not conclusive, might affect the plaintiff's right to recover. That a license has not been considered an interest in land[7] while an easement has been so considered[8] immediately suggests a difference between the two that could be decisive. Without prior determination of the nature of plaintiff's right to maintain the action, the conclusion that "Any one having an interest in land is liable to suffer injury in respect to his right,"[9] becomes nothing more than a mere truism and affords no basis to support this decision.

A license is permission to do something, which would otherwise be unlawful, on the land of another without possessing any estate or interest therein.[10] No formal words are necessary to create a license.[11] Thus, it may

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4 402 S.W.2d 640 (Ark. 1966).

5 *Ibid.*

6 *Id.* at 642.

7 Radke v. Union Pac. Ry., 138 Colo. 189, 334 P.2d 1077 (1959); Boland v. Walters, 346 Ill. 184, 178 N.E. 359 (1931); Sweeney v. Bird, 293 Mich. 624, 292 N.W. 506 (1940); St. Michaels Russian Orthodox Greek Catholic Church v. Clark, 37 Ohio App. 200, 174 N.E. 607 (1930); Settegast v. Foley Bros. Dry Good Co., 114 Tex. 452, 270 S.W. 1014 (1925); Coumas v. Transcontinental Garage Inc., 68 Wyo. 99, 230 P.2d 748 (1951).

8 United States v. Fixico, 115 F.2d 389 (10th Cir. 1940); Eastman v. Piper, 68 Cal. App. 554, 229 Pac. 1002 (1924); Jenkins v. Brown, 48 Ga. App. 480, 173 S.E. 257 (1934); Peaslie v. Dietrich, 365 Mich. 338, 112 N.W.2d 562 (1961); Borders v. Yarbrough, 237 N.C. 540, 75 S.E.2d 541 (1953); Watson v. Wiseheart, 258 S.W.2d 350 (Tex. Civ. App. 1953).

9 Carson v. Hercules Powder Co., *supra* note 1, at 642.

10 Wynn v. Garland, 19 Ark. 23 (1857); Polley v. Ford, 190 Ky. 579, 227 S.W. 1007 (1921); Nelson v. American Tel. & Tel. Co., 270 Mass. 471, 170 N.E. 416 (1930); Rodefer v. Pittsburg O.V. & C.R. Co., 72 Ohio St. 272, 74 N.E. 183 (1905); Yeager v. Tuning, 79 Ohio St. 121, 86 N.E. 657 (1908); Toussaint v. Stone, 116 Vt. 425, 77 A.2d 824 (1951); 25 Am. Jur. 2d *Easements & Licenses* § 123 (1966); 2 American Law of Property § 8.112 (Casner ed. 1952).

11 Seaboard Air Line Ry. v. Dorsey, 111 Fla. 22, 149 So. 759 (1932).

arise from an express grant,[12] be implied from the actions of the parties,[13] or arise from acquiesence of the landowner to certain acts done on his property.[14] In *McKee v. Oratz*,[15] the Supreme Court held that a license to hunt and fish may be implied from custom and the habits of the country. Similarly, in *Moundsville Water Co. v. Moundsville Sand Co.*,[16] the court found that the maintenance of a pipe line over the land of another for a substantial time, without objection, gives the plaintiff at least the rights of a licensee. A license may be created either by written instrument[17] or oral agreement since it is not an interest in realty and therefore not within the Statute of Frauds.[18] No consideration is necessary to make a valid license.[19] A license is personal and unassignable.[20] Thus, *DeHaro v. United States*[21] held that a license "ceases with the death of either party, and cannot be transferred or alienated by the licensee because it is a personal matter, and, is limited to the original parties to it." Also, a license is generally held to be revocable at the will of the licensor,[22] but this general rule is subject to two exceptions. First, a license coupled with an interest is irrevocable.[23] For example, where one has purchased a chattel located on the vendor's land, a license, either express or implied, to enter and remove the chattel sold cannot be revoked. Second, where a licensee, under the grant of a license, makes expenditures in

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12 *E.g.*, Rodefer v. Pittsburg O.V. & C.R. Co., *supra* note 10; Callaghan v. Callaghan, 25 Ohio App. 96, 157 N.E. 806 (1926); Metcalf v. Hart, 3 Wyo. 513, 27 P. 900 (1891).

13 Cutler v. Smith, 57 Ill. 252 (1870); Kein v. Downing, 157 Neb. 481, 59 N.W.2d 602 (1953).

14 Fischer v. Johnson, 106 Iowa 181, 76 N.W. 658 (1898); Leninger v. Goodman, 277 Pa. 75, 120 Atl. 772 (1923); Eastman v. Piper, *supra* note 8.

15 260 U.S. 127 (1922).

16 124 W.Va. 118, 19 S.E.2d 217 (1942).

17 Burdine v. Sewell, 92 Fla. 375, 109 So. 648 (1926); Cutler v. Smith, *supra* note 13; Nelson v. American Tel. & Tel. Co., *supra* note 10; Sweeney v. Bird, *supra* note 7.

18 Wynn v. Garland, *supra* note 10; Eastman v. Piper, *supra* note 8; Commercial Nat'l Bank v. Carnahan, 128 Kan. 87, 276 Pac. 57 (1929); St. Michaels Russian Orthodox Greek Catholic Church v. Clark, *supra* note 7; Yeager v. Tuning, *supra* note 10.

19 McClintic-Marshall Co. v. Ford Motor Co., 254 Mich. 305, 236 N.W. 792, 795 (1931); Spalding v. Archibald, 52 Mich. 365, 17 N.W. 940 (1883).

20 Eastman v. Piper, *supra* note 8; Davidson v. Dingeldine, 295 Ill. 367. 129 N.E. 79, 82 (1920); Snowden v. Wilas, 19 Ind. 10 (1862); Sweeney v. Bird, *supra* note 7; St. Michaels Russian Orthodox Greek Catholic Church v. Clark, *supra* note 7; Towery v. Garber, 196 Okla. 78, 162 P.2d 878 (1945); Nunnelly v. Southern Iron Co., 94 Tenn. 397, 29 S.W. 361 (1894).

21 7 U.S. (5 Wall.) 599, 627 (1866).

22 *E.g.*, Wheeler v. West, 71 Cal. 126, 11 Pac. 871 (1886); Elswick v. Ramey, 157 Ky. 639, 163 S.W. 751 (1914); Spencer v. Rabidau, 340 Mass. 91, 162 N.E.2d 767 (1959); Stalder v. Miles, 108 Neb. 386, 387 N.W. 854 (1922).

23 McLeod v. Dial, 63 Ark. 10, 37 S.W. 306 (1896); Holt v. City of Montgomery, 212 Ala. 235, 102 So. 49 (1924); Lambert v. Robinson, 162 Mass. 34, 37 N.E. 753 (1894); Sterling v. Warden, 51 N.H. 217 (1871); Metcalf v. Hart, *supra* note 12.

reliance upon the license, the licensor will be estopped from revoking so long as equitable principles require.[24]

A license is distinguished from an easement or profit a prendre[25] in that the latter two imply an interest in land and therefore come within the purview of the Statute of Frauds.[26] A license is distinguished from a lease in that a lease transfers exclusive possession to the lessee[27] and also may be required to be written.[28]

Most courts and writers agree that the holder of an easement, by virtue of having a property right, is entitled to protection of his rights and privileges against interference by strangers, either in law for damages or in equity for an injunction to prevent further interference.[29] Had the grants in the *Carson*

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[24] Keystone Copper Mining Co. v. Miller, 63 Ariz. 544, 164 P.2d 603 (1945); Munch v. Stetler, 109 Minn. 403, 124 N.W. 14 (1910); Coumas v. Transcontinental Garage Inc., *supra* note 7; First Church of Christ Scientist v. Revell, 68 S.D. 377, 2 N.W.2d 674 (1942) (dictum); Harris v. Brown, 202 Pa. 16, 51 Atl. 586 (1902).

[25] *See* Hahner, "An Analysis of Profits a Prendre," 25 Ore L. Rev. 217 (1946); 25 Am. Jur. 2d *Easements & Licenses* § 4 (1966); 3 Tiffany, Real Property § 839 (3d ed. 1939). Historically, a distinction has been made between easements and profits a prendre, but today the difference is of little significance, the two being treated together by legal writers. Technically, a profit a prendre is defined as a right exercised by one person in the soil of another, or a right to take part of the soil; whereas an easement is a liberty, privilege or advantage in land without profit, existing distinct from ownership. Thus, while the right to maintain a sewer or right of way over the land of another theoretically may, if properly executed, constitute an easement, the right to enter and cut timber on the land of another, or to hunt and fish would historically be a profit a prendre. Aside from the nature of the act to be performed, there is no distinction between the two. The two are very similar in that both involve use and enjoyment of the land, are non-possessory, involve rights and privileges relative to the property, involve rights against society in general, and, being interests in land, must be created by a properly executed writing. There being no reason to distinguish between the two, using the two terms can only lead to confusion; therefore, the better known and understood of the two terms, easement, should be used.

[26] Fulcher v. Dierks Lumber & Coal Co., 164 Ark. 261, 261 S.W. 645, 648 (1924) (dictum); Empire Investment Co. v. Mort, 169 Cal. 732, 147 Pac. 960 (1915); Wilken v. Irvine, 33 Ohio St. 138 (1877); Clark v. Glidden, 60 Vt. 702, 15 Atl. 358, 360 (1888); Cottrell v. Nurnberger, 131 W.Va. 391, 47 S.E.2d 454 (1948).

[27] Rochester Poster Advertising Co. v. State, 27 Misc. 2d 99, 213 N.Y.S.2d 812 (Ct. Cl. 1961); Ohio Valley Advertising Corp. v. Linzell, 107 Ohio App. 351, 152 N.E.2d 380, *aff'd* 168 Ohio St. 259, 153 N.E.2d 773 (1958); Strandholm v. Barbey, 145 Ore. 427, 26 P.2d 46 (1933); Note, "Real Property-Leases-Licenses-Easements," 14 Ala. L. Rev. 210 (1961).

[28] Ark. Stat. Ann. § 38-101 (1947):

No action shall be brought . . . to charge any person upon any lease of lands, tenements or hereditaments for a longer term than one [1] year.

See Ohio Rev. Code Ann. § 1335.04 (Page 1962).

[29] *E.g.*, Buckley v. Marson, 120 Conn. 511, 181 Atl. 922 (1922) (damages); Dewire v. Hanley, 79 Conn. 454, 65 Atl. 573 (1907) (injunction); Metts v. O'Connell, 13 Del. Ch. 420, 126 Atl. 276 (1923) (injunction); Powers v. Ward, 200 Ky. 478, 255 S.W. 105 (1932) (damages).

case been by properly executed writing the inquiry could end. But in fact, the permission was oral and therefore was ineffective to pass an interest in land.

It is possible, however, that since the plaintiff had been fishing in the stream since 1927, he had acquired an easement by prescription. The general requirements to acquire an easement by prescription are that the use must be adverse, open and notorious, uninterrupted, under claim of right, for the period of the statute of limitations.[30] The decisive factor is that the use must be adverse and not merely permissive. There is much authority that use under a parol grant, void because of the Statute of Frauds, is adverse and not permissive,[31] the theory being that the use is under claim of right.[32] In *Phillips v. Phillips*,[33] the court said, "It is generally held that a permissive use can never ripen into an easement by prescription, at least during the period within which permission is granted, but this rule does not apply where there has been an attempt to grant an easement which is void because of the Statute of Frauds." Whether the parties intended to grant a license or an easement, then, becomes very important, and must be determined from the language used.[34] Thus, in the *Carson* case, it is possible, assuming that the intent of the parties was to create an interest in land and not a mere license, that the plaintiff had acquired an easement by prescription to fish in the stream, if the remaining requirements to create an easement by prescription were met.[35] However, if the parties had intended merely to vest the plaintiff with a license, the use for all the years would have been permissive and would have prevented plaintiff's acquisition of an easement by prescription.

If the plaintiff were a bare licensee, he would seem to be precluded from maintaining an action in trespass or nuisance. Historically the action of trespass was for protection of the interest in exclusive possession.[36] Nuisance was an invasion of interests in land, any interest that could be classified as a property right being capable of supporting the action.[37] Additionally, pro-

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30 *See* 25 Am. Jur. 2d *Easements & Licenses* § 39-63 (1966); 2 American Law of Property § 8.44 (Casner ed. 1952); 2 Thompson, Real Property, § 335-41 (1961 replacement).

31 *E.g.*, Peterson v. Corrubia, 21 Ill. 2d 525, 173 N.E.2d 499 (1961); Phillips v. Phillips, 215 Md. 28, 135 A.2d 849 (1957); Auxier v. Horn, 213 S.W. 100 (Mo. 1919) (dictum); Jenson v. Gerrard, 85 Utah 481, 39 P.2d 1070 (1935).

32 Klein v. DeRosa, 137 Conn. 586, 79 A.2d 773 (1951); Phillips v. Phillips, *supra* note 31; Huges v. Boyer, 5 Wash. 2d 81, 104 P.2d 760 (1940).

33 215 Md. 28, 135 A.2d 849, 851 (1957).

34 Phillips v. Phillips, *supra* note 31; Wells v. Parker, 74 N.H. 193, 66 Atl. 121 (1907).

35 References cited note 30 *supra.*

36 Leach v. Woods, 31 Mass. (14 Pick.) 461 (1833); Abbott v. Abbott, 51 Me. 575 (1863). A mere licensee, not being entitled to exclusive possession, can bring no action for trespass. Sabine & E.T.R. Co. v. Johnson, 65 Tex. 389 (1886).

37 McClosky v. Martin, 56 So. 2d 916 (Fla. 1951) (tenant); Brink v. Moeschl

tection of a licensee from interference by strangers with his license is denied because a license generally is revocable at the will of the licensor; hence, the value of the thing injured would be speculative and hard to measure.[38] Perhaps this conclusion is not as judicially tenable as might appear at first glance. For instance, in the present case, the measure of damages to the plaintiff for lost income from 1963 to 1965 is no more difficult to measure than if the riparian owners were suing. The valuation problem would be involved only if the plaintiff were seeking recovery for permanent damage to the stream.

Despite difficulties with the theories of common law actions and problems in measuring damages, a licensee's standing to sue for interference with his license has been gaining acceptance. Cases in this area may be divided into two categories: (1) cases in which a licensee sued for damage to property which he had placed on the land of the licensor for use in exercising the license,[39] and (2) cases in which the licensee sued for injury or threatened injury to maintenance of the license itself.[40] An examination of the cases reveals that courts are more willing to grant relief in the former class than in the latter. Typical of cases in the first area is *Moundsville Water Co. v. Moundsville Sand Co.*,[41] in which the holder of a license to maintain a sewer line over the land of another recovered from a third person who had damaged the sewer pipes. Similarly, in *Miller v. Greenwich Township*,[42] the court held that one who was licensed to maintain a sewer over another's land, which sewer had been destroyed by a stranger, was entitled to damages from the stranger. The court held that an unrevoked license has value.

A factor common to all cases where injury occurred to property placed on the licensor's land is that the license was probably irrevocable because the licensee had made expenditures in reliance upon the license, thereby estopping revocation by the licensor,[43] or irrevocable because the license was coupled with an interest.[44] The view of the authors of the Restatement of Property[45] is that a licensee is entitled to protection against interference by

Edwards Corrugating Co., 143 Ky. 88, 133 S.W. 1147 (1911) (adverse possessor); Herman v. Roberts, 119 N.Y. 37, 23 N.E. 442 (1890) (holder of an easement).

38 2 American Law of Property § 8.125 (Casner ed. 1952); Restatement, Property § 521 (1944). *But see*, In re Primary Rd. No. Iowa 141, 114 N.W.2d 290 (Iowa 1962).

39 Moundsville Water Co. v. Moundsville Sand Co., 124 W.Va. 118 (1942); 19 S.E.2d 217; Miller v. Greenwich Township, 62 N.J.L. 771, 42 Atl. 735 (1899); Miller v. Rambo, 62 N.J.L. 191, 49 Atl. 453 (1901); Keystone Lumber Co. v. Kolman, 94 Wis. 465, 69 N.W. 165 (1896); In re Primary Rd. No. Iowa 141, *supra* note 38.

40 Elliot v. Town of Mason, 76 N.H. 229, 81 Atl. 701 (1911); Moulton v. Bunting McWilliams Post No. 658 VFW, 213 Ga. 859, 102 S.E.2d 593 (1958); Sabine & E.T.R. Co. v. Johnson, *supra* note 36; Powers v. Clarkson, 17 Kan. 218 (1876); Case v. Weber, 2 Ind. 108 (1850).

41 19 S.E.2d 217, 124 W.Va. 118 (1942).

42 62 N.J.L. 771, 42 Atl. 735 (1899).

43 Cases cited note 24 *supra*.

44 Cases cited note 23 *supra*.

45 Restatement of Property § 521 (1944):

third parties to the extent that he is a possessor against such parties, which means that he must have a relation to the land so as to give him some physical control over it. However, irrespective of the licensee's physical control, if his license is revocable at the will of the licensor, protection against third persons will be denied. Protection will not be denied, however, to the extent a license has become irrevocable through expenditures made in reliance upon representations by the licensor or when the license is coupled with an interest. Thus the facts of each case necessarily determine its disposition.

Representative of cases in which injury occurred to the use and enjoyment of the license is *Elliot v. Town of Mason.*[46] In *Elliot,* the court held that occupation of land by a licensee did not vest him with a legal interest therein; hence, he could not recover for interference with his use and enjoyment of the land caused by operation of an alleged nuisance by the defendant. Similarly, where a licensee was permitted to graze cattle on land of another, he was refused recovery for damage to the grazing land.[47] In neither case had the license become irrevocable.

In the present case, plaintiff was suing for injury to his physical utilization of the land, and not for damage to tangible property placed on the land; hence, his activities seem to have fallen within cases of the second category. The court found, however, that the plaintiff ". . . had a substantial investment in a business that had been in operation since 1927."[48] Therefore, the license had possibly become irrevocable, placing plaintiff within the Restatement[49] rule and the group of cases where the licensee recovered.[50]

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(1) Except as stated in Subsections (2), (3), and (4), a licensee, as such, is entitled to no protection against interference by third persons with the use privileged by the license.

(2) A licensee is entitled to protection against interference by third persons with the use privileged by the license to the extent to which the licensee gives him possession as against such persons.

(3) To the extent to which a license coupled with an interest is not terminable at the will of the possessor of the land subject to it, the licensee is entitled to protection against interference by third persons with the use privileged by the license.

(4) To the extent to which such a license as described in § 514 has become irrevocable through the expenditures of capital or labor in reasonable reliance upon representations by the licensor (§ 519, Subsection (4)), the licensee is entitled to protection against interference by third persons with the use privileged by the license.

[46] 76 N.H. 229, 81 Atl. 701 (1911). In Kavanagh v. Barber, 131 N.Y. 211, 30 N.E. 235 (1892), the court said that allowing a mere licensee to recover for the maintenance of a private nuisance will greatly extend the class of actionable nuisances and that the action would only lie for the owner of the land or one having some legal interest like a lessee, the enjoyment of which was affected by the nuisance.

[47] Sabine & E.T.R. Co. v. Johnson, *supra* note 36, Powers v. Clarkson, *supra* note 40.

[48] Carson v. Hercules Powder Co., *supra* note 1 at 642.

[49] Restatement of Property § 521 (1944).

[50] Cases cited note 39 *supra.*

In summary, the protection afforded holders of easements and licenses against interference by strangers with their rights differs due to the nature of the interest. However, because the law does not place the label "property right" or "interest in land" on a licensee's right does not mean it is of no value to him. Obviously, a license can be of great value, as in the instant case. In such a case, where the licensee has made expenditures in reliance on representations by the licensor, the licensor is precluded from revoking under the equitable doctrine of estoppel.[51] The law protects the licensee from damage by the licensor, and sound policy would require similar protection from damage caused by a stranger.

TORTS—THE STRICT TORT LIABILITY OF BUILDER-VENDORS—*State Store Mfg. Co. v. Hodges*, —— *Miss.* ——, *189 So. 2d 113 (1966)*—Defendant contractors built a home for plaintiffs. As part of the construction, the contractors installed an electric water heater made by the co-defendant manufacturer. The manufacturers' instructions directed installation of a combination temperature and pressure relief valve on the heater. The contractors' agent failed to so install the valve. Eight months after the contractors had turned over the house to plaintiffs and during a time when the plaintiffs were away from their home, the water heater exploded, substantially destroying the house and all personal property in it. Plaintiffs brought a negligence action against both the contractors and the manufacturer. The trial court found that two thermostats installed by the manufacturer had failed to work, thus causing the temperature in the heater to increase to a point where a plastic tube melted and blocked the entry of cold water into the heater and that consequently the temperature and pressure rose so high that an explosion resulted. The trial court dismissed the suit against the contractors and held the manufacturer liable for negligence. On appeal, the Mississippi Supreme Court reversed, holding that the manufacturer was not liable to the plaintiffs, since the contractors' failure to install the combination temperature and pressure relief valve as directed evidenced that the heater was not expected to and did not reach the plaintiffs without substantial change in condition. Further, the court, relying on the Restatement test of strict liability,[1] found that the contractors' failure to install the combina-

[51] Cases cited note 24 *supra*.

[1] Restatement (Second) of Torts § 402A (1965) [hereinafter cited as Restatement 2d] provides:

> Special Liability of Seller of Product for Physical Harm to User or Consumer
>
> (1) One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to his property, if
>
> (a) the seller is engaged in the business of selling such a product, and
>
> (b) it is expected to and does reach the user or consumer without substantial change in the condition in which it is sold.

tion valve as directed rendered them strictly liable in tort because (1) without this valve, the heater was in a defective condition and not reasonably safe for its intended purpose and (2) the contractors expected the heater to reach the plaintiffs in that condition.

This decision has brought Mississippi into the forefront of the products liability field. The court first dispensed with the requirement of privity of contract, to which Mississippi state courts had tenaciously held during the fifty years since *MacPherson v. Buick Motor Co.*,[2] began the erosion of the privity requirement in products liability actions. By so doing, Mississippi is now in accord with the rest of the states, and privity of contract is virtually a dead letter in tort actions involving products liability.[3]

After eradicating the privity requirement, the court joined with the highest courts of thirteen[4] other states in adopting the doctrine of strict liability in tort. This theory that liability may be imposed without proof of defendant's negligence has developed from cases involving the liability of a manufacturer of food and drink and was first articulated in 1927 in the Mississippi case of *Coca-Cola Bottling Works v. Lyons*.[5] There the court developed the notion of a "warranty" running from manufacturer to consumer, like a covenant running with the land, for injuries sustained by plaintiff due to broken glass in a soft-drink bottle. Plaintiff was not put to a proof of the manufacturer's negligence but rather required only to prove the defective nature of the product, her rightful title to it, and her consequent injuries.[6] While this finding of liability could have rested on several sound bases,[7] the court chose the terminology of "warranty," a choice generally accepted in later cases but one which has caused unnecessary confusion.[8] The term "warranty," generally associated with contract actions, has tended to becloud the idea that plaintiff's action and recovery are in tort, thus making the absence of a contract irrelevant.[9] Furthermore, "warranty" as

(2) The rule stated in Subsection (1) applies although

(a) the seller has exercised all possible care in the preparation and sale of his product, and

(b) the user or consumer has not bought the product from or entered into any contractual relation with the seller.

[2] 217 N.Y. 382, 111 N.E. 1050 (1916).

[3] State Stove Mfg. v. Hodges, 189 So. 2d 113, 116 (1966); Prosser, Torts, 661-63 (3d ed. 1964).

[4] CCH Prod. Liab. Rep. ¶ 4070 (1966).

[5] 145 Miss. 876, 111 So. 305 (1927).

[6] State Stove Mfg. v. Hodges, *supra* note 3, at 118. Some writers contend that such a showing requires virtually the same proof as in a negligence action. See Keeton, "Products Liability—Some Observations about Allocation of Risks" 64 Mich L. Rev. 1329, 1340-41 (1966).

[7] See notes 17-20 *infra*, and accompanying text.

[8] State Stove Mfg. v. Hodges, *supra* note 3, at 119, citing Prosser, *supra* note 3, at 678-79.

[9] Greenman v. Yuba Power Products, Inc., 59 Cal. 2d 57, 63, 27 Cal. Rptr. 697, 701, 377 P.2d 897, 901 (1963); Restatement 2d, § 402A, comment m.

a basis for strict liability became confused with the warranties of the law of sales, *e.g.*, the implied warranties of merchantability and fitness.[10] Such defenses as the failure of purchaser to rely on seller's skill and judgment,[11] failure of purchaser to give notice of breach of warranty to seller,[12] and disclaimer of warranty liability,[13] while perfectly valid in sales actions, are not relevant to an action in tort,[14] where a manufacturer's liability is imposed by operation of the law, not by contract.[15] Accordingly, numerous courts, as in the principal case, have discarded the terminology of "warranty" and explicitly recognized that a manufacturer's liability is grounded on strict liability in tort.[16] The various rationales advanced for this doctrine are: 1) The manufacturer, in placing his goods on the market, gives the consumer an implied assurance that they are safe for their general purposes;[17] 2) The manufacturer is better able to bear and/or distribute risks than the consumer or injured third party;[18] 3) A suit against the manufacturer eliminates a multiplicity of indemnity actions;[19] 4) Holding a manufacturer strictly liable will be an incentive towards due care by manufacturers, thus protecting the lives and safety of the public.[20]

This doctrine of a manufacturer's strict liability has in this decade been extended to a myriad of products other than food and drink.[21] In addition, courts have fixed strict liability not only on manufacturers, but also on makers of component parts, assemblers of parts, retailers, wholesalers, and lessors.[22] The principal case extends the doctrine of strict liability in tort, irrespective of "warranty," to building contractor-vendors for the first time, a

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[10] Uniform Commercial Code §§ 2-314, 2-315 (1962).

[11] *Id.* § 2-315. Pritchard v. Liggett & Myers Tobacco Co., 350 F.2d 479, 491 (3d Cir. 1965) holds similarly under the Uniform Sales Act.

[12] *Id.* § 2-607(3)(a). See also Pritchard v. Liggett & Myers Tobacco Co., 295 F.2d 292 (3d Cir. 1961).

[13] *Id.* § 2-316. §§ 2-302 and 2-719(3) indicate that such disclaimers or limitations on liability must not be unconscionable.

[14] Vandermark v. Ford Motor Co., 61 Cal. 2d 256, 37 Cal. Rptr. 896, 391 P.2d 168 (1964); Greenman v. Yuba, *supra* note 9; Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69 (1960); Prosser, *supra* note 3 at 681. Contributory negligence may, however, be a valid defense to a strict liability action. See Maiorino v. Weco Products Co., 45 N.J. 570, 214 A.2d 18 (1965).

[15] *See* authorities cited note 9 *supra*.

[16] State Stove v. Hodges, *supra* note 3 at 118-20, citing Restatement 2d and numerous cases. See also Prosser, "The Fall of the Citadel (Strict Liability to the Consumer)" 50 Minn. L. Rev. 791, 804 n.80, for a listing of authorities.

[17] Greenman v. Yuba, *supra* note 9, at 63-64; Prosser, *supra* note 16, at 799.

[18] Schipper v. Levitt, 44 N.J. 70, 207 A.2d 314 (1965); Santor v. A. & M. Karagheusian, Inc., 44 N.J. 52, 207 A.2d 305 (1965).

[19] Prosser, *supra* note 3, at 674.

[20] *Id.* at 673-74.

[21] Wade, "Strict Tort Liability of Manufacturers" 19 Sw. L.J. 5, 12 (1965); Prosser, *supra* note 3, at 678.

[22] Prosser, *supra* note 16, at 814-16.

most noteworthy development in view of the aura of *caveat emptor* that has traditionally protected builder-vendors.

This notion of *caveat emptor*, strongly established in the law during the sixteenth and seventeenth centuries,[23] found expression in the rule that a builder-vendor would not be liable for injuries due to defective construction unless express warranties in the deed so provided; no liability was imposed by operation of the law.[24] The reasons usually advanced for this rule were: 1) The purchaser has ample opportunity to inspect the structure for defects;[25] 2) The deed merges all prior agreements. Thus, if there is no express warranty in the deed concerning liability for defective construction, there is no liability;[26] 3) When a builder's control over the structure ceases, so should his responsibility.[27] Otherwise, a builder would be subjected to indeterminate liability, causing chaos in the real estate business.[28]

This rule of nonliability of building contractors is, of course, a specific example of the general rule of nonliability propounded in *Winterbottom v. Wright*.[29] Like the *Winterbottom* rule, the rule for building contractors became riddled with exceptions that finally overbore it. One such exception was that the builder-vendor would be held liable in a negligence action if he failed to disclose to the purchaser his knowledge of latent defects involving an unreasonable risk of harm.[30] Another was the finding of builder-vendor's liability for negligence if the defect rendered the structure inherently or imminently dangerous to life and health.[31] A third exception found the builder's implied invitation to a third party as a basis for duty and consequent negligence liability.[32]

As was the case with manufacturers' liability, the general rule of nonliability gave way to these exceptions. Thirty-two years after its inception,

23 Hamilton, "The Ancient Maxim Caveat Emptor," 40 Yale L.J. 1133 (1931).

24 Ford v. Sturgis, 14 F.2d 253 (1926), *overruled* in Hanna v. Fletcher, 231 F.2d 469 (1956); Berger v. Burkoff, 200 Md. 561, 92 A.2d 376 (1952); Kerr v. Parsons, 83 Ohio App. 204, 82 N.E.2d 303 (1948).

25 Otto v. Bolton and Norris [1936] 2 K.B. 46, 52.

26 Coutrakon v. Adams, 39 Ill. App. 2d 290, 188 N.E.2d 780 (1963), *aff'd*, 31 Ill. 2d 189, 201 N.E.2d 100 (1964).

27 Mercer v. Meinel, 290 Ill. 395, 125 N.E. 288 (1919); Smith v. Tucker, 151 Tenn. 347, 270 S.W. 66 (1924).

28 Curtin v. Somerset, 140 Pa. 70, 21 Atl. 244 (1891).

29 10 M. & W. 109, 152 Eng. Rep. 402 (1842).

30 Murphy v. Barlow, 206 Minn. 527, 289 N.W. 563 (1939); Kilmer v. White, 254 N.Y. 64, 171 N.E. 908 (1930). This exception to nonliability is analagous to the exception finding liability for a seller established in Lewis v. Terry, 111 Cal. 39, 43 Pac. 398 (1896) and Schubert v. J. R. Clark Co., 49 Minn. 331, 51 N.W. 1103 (1892).

31 Berg v. Otis Elevator Co., 64 Utah 518, 231 Pac. 832 (1924). A comparable holding in the area of manufacturers' and sellers' liability had been Blood Balm Co. v. Cooper, 83 Ga. 457, 10 S.E. 118 (1889) and Thomas v. Winchester, 6 N.Y. 397.

32 Grodstein v. McGivern, 303 Pa. 555, 154 Atl. 794 (1931). The counterparts in the manufacturers' and sellers' area had been Devlin v. Smith 89 N.Y. 470 (1882) and Heaven v. Pender [1883] 11 Q.B.D. 503.

the *MacPherson* rule was extended to builder-vendors, making them liable in negligence suits for injuries sustained by one foreseeably endangered by a structural defect.[33] The courts so holding have made clear the

> close analogy between a supplier of chattels and a general contractor for the construction of a building. . . . Surely there is no valid distinction between a general contractor constructing a building and using subcontractors to install equipment therein, and the manufacturer of an automobile buying parts not fabricated by it to install in the car, and selling the assembled car. There should be liability in both cases.[34]

This parallel between builder-vendors and manufacturers of chattels has also found expression in actions based on a theory of implied warranty of habitability, much akin to the sales warranties of fitness and merchantability.[35] For example, a Colorado case[36] has held that a plaintiff, being unable to conduct an effective inspection of a house, would have a good cause of action in contract against a builder-vendor based on an implied warranty that the house would be fit for its intended use. Such a warranty could be extended to cover liability for personal injury,[37] but it would, of course, be subject to "the trappings of warranty laws."[38] Similarly, recovery in negligence is often hampered by problems of proof, notably in attempts to invoke *res ipsa loquitur*.[39] Perhaps these are the major reasons for the development of the doctrine of strict liability in tort in regard to builder-vendors. It sidesteps many of the above problems by not requiring proof of negligence and by abrogating the usual sales warranty defenses.[40]

This idea of a builder-vendor's strict liability was first expressed, al-

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[33] Moran v. Pittsburgh-Des Moines Steel Co., 166 F.2d 908 (3d Cir. 1948); Dow v. Holly Mfg. Co., 49 Cal. 2d 720, 321 P.2d 736 (1958); Inman v. Binghamton Housing Authority, 3 N.Y.2d 137, 164 N.Y.S.2d 699, 143 N.E.2d 895 (1957). "The last few years have seen a flood of decisions extending the rule of the *MacPherson* case to building contractors." Prosser and Smith, Cases and Materials on Torts, 859 (3d ed. 1962). *See also* Krause, "Products Liability and the Independent Contractor," 1964 U. Ill. L.F. 748, 753 (1964).

[34] Dow v. Holly, *supra* note 33, at 726-27, 321 P.2d at 739-40.

[35] *Supra* note 10. This use of "warranty" is in the context of the law of sales and is not to be associated with "warranty" as a synonym for strict liability in tort. See notes 7-10 *supra* and accompanying text.

[36] Carpenter v. Donohoe, 154 Colo. 78, 388 P.2d 399 (1964).

[37] Keeton, *supra* note 6, at 1345.

[38] Sebert, "Products Liability—The Expansion of Fraud, Negligence, and Strict Tort Liability," 64 Mich. L. Rev. 1350, 1370 (1966). In addition to the availability of the usual sales warranty defenses, *supra* notes 11-13, many courts have held that a warranty is implied only until completion of the house. See Hoye v. Century Builders, Inc., 52 Wash. 2d 830, 329 P.2d 474 (1958), assumed without so holding, and Miller v. Cannon Hill Estates, Ltd., [1931] 2 K.B. 113. *Accord*, Inman v. Binghamton, *supra* note 33, for negligence actions.

[39] Sebert, *supra* note 38, at 1363-68.

[40] Restatement 2d § 402A, comment m.

though in a guise of "warranty," by the same court that had, five years earlier in *Henningsen v. Bloomfield Motors*,[41] expanded the coverage of "warranty" to products beyond food and drink. The New Jersey Supreme Court in *Schipper v. Levitt*,[42] held that a mass builder-vendor could be liable on an implied warranty of habitability to a plaintiff who was not in privity with the builder and who had sustained injuries due to a defect in the structure; no proof of negligence was required. Citing the products' liability cases, the court grounded this finding on: 1) The absence of any clear distinction between a builder-vendor and a manufacturer or seller of chattels; 2) The injured party's reliance on the builder-vendor's skill owing to the former's inability to make an effective inspection; 3) The disparity of economic resources between a mass builder-vendor and an individual purchaser; and 4) The consequent proposition that risks ought to be borne by the builder.[43] While it seems clear that the primary thrust of this opinion is towards strict liability in tort, the language of "implied warranty of habitability" may well cause confusion similar to that in the chattel cases.[44] Already one case[45] has cited *Schipper* as authority for implying, in regard to a house, a warranty of fitness akin to that of the law of sales.[46] In abandoning the rationale of "warranty" for the doctrine of strict liability in tort, the principal case avoids these problems. For example, it sidesteps the effect of statutes that prohibit the implication of any warranties in the conveyance of real property.[47] It makes clear that the defendant's liability is in tort, based on his implied representation of the safety of his product and his superior risk-bearing ability,[48] thus making irrelevant the usual contract defenses. By bringing builder-vendors within the *Restatement* test of strict liability,[49] this case emphasizes the analogy between builders and manufacturers and has speeded up the development of tort law in regard to building contractors.[50] Just as *Greenman*[51] advanced the notion of strict liability beyond the "warranty" terminology of *Henningsen*,[52] the principal case moves beyond *Schipper*[53] in establishing the strict liability of builder-vendors, be they mass-producers of houses or contractors doing a modest business.[54]

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[41] *Supra* note 14. This case implied a "warranty," in the strict liability sense, running from the manufacturer and dealer of a defective automobile to the purchaser's wife injured as a result of that defect.

[42] *Supra* note 18. Defendant builder-vendor advertised that the water systems in its homes produced extraordinarily hot water. Instead of using any special protective device, defendant merely used the usual mixing-type faucet and warned occupants to always turn on the cold water before the hot. One who purchased a home from defendant leased it to plaintiff, whose small son was scalded by the hot water.

[43] "The public interest dictates that if such injury does result from the defective construction, its cost should be borne by the responsible developer who created the danger and who is in the better economic position to bear the loss rather than by the injured party who justifiably relied on the developer's skill and implied representation." Schipper v. Levitt, *supra* note 18, at 91, 207 A.2d at 326.

[44] *See* notes 7-16, *supra*, and accompanying text.

[45] Bethlahmy v. Bechtel, — Idaho —, 415 P.2d 698 (1966). See also Rosenau v.

Apart from the general arguments concerning the concept of strict tort liability,[55] there are numerous arguments in regard to the imposition of such liability specifically on builder-vendors. For example, one argument against such imposition is based upon serious doubts as to the validity of the analogy of builders and manufacturers, an analogy that lies at the heart of the extension of strict liability to builder-vendors.[56] It is argued that a house or a building is a far more complex entity than a chattel and consequently has a greater probability of being defective. It is contended that a mass-produced chattel is quite different from a house made to the owner's specifications. Furthermore, the analogy is doubted on the basis that a manufacturer produces a product, while a building contractor performs a service, which ought to be beyond the scope of products liability.

Another major argument against the imposition of strict tort liability is that if causation of injury can be shown, the effect of the statute of limitations is eradicated. Proponents of this view cite cases where recovery has been made in negligence suits for injuries sustained eighteen years after completion of the house.[57] These proponents argue that the policies in favor of repose and against speculative lawsuits are laid asunder by such holdings.

A third argument is that the imposition of strict tort liability on builders ought properly to be a legislative, not a judicial, function.[58] Imposition

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City of New Brunswick, 93 N.J. Super 49, 224 A.2d 689 (1966), where the court held that the statute of limitations applicable to sales warranties was a valid defense to an action in strict tort liability.

[46] Uniform Commercial Code § 2-315 (1962). Arguably, this warranty approach gives a broader remedy than strict liability in tort, since "warranty" may justify recovery for loss of bargain, as well as damage to person and property. See 51 Cornell L.Q. 389, 398-99, (1965) and Keeton, *supra* note 6, at 1344-46, discussing Seedy v. White Motor Co., — Cal. 2d —, 45 Cal. Rptr 17, 403 P.2d 145 (1965). This only further demonstrates the essential differences between sales warranties and strict liability in tort.

[47] *See, e.g.*, Ore. Rev. Stat. § 93.140 (1965).

[48] State Stove v. Hodges, *supra* note 3, at —, 189 So. 2d at 119-20.

[49] Restatement 2d § 402A. State Stove v. Hodges, *supra* note 3, at —, 189 So. 2d at 123-24.

[50] "The law as to building contractors has, in general, developed along the same lines as that of manufacturers and sellers of chattels, but has tended to lag some twenty or thirty years behind it." Prosser and Smith, *supra* note 33, at 858.

[51] Greenman v. Yuba, *supra* note 9.

[52] Henningsen v. Bloomfield Motors, *supra* note 14.

[53] Schipper v. Levitt, *supra* note 18.

[54] Schipper v. Levitt stressed the mass-production position of defendant, the developer of the various "Levittowns." The principal case made no reference to the size of the contractors' business.

[55] *See* Sebert, *supra* note 38, at 1370 n.115 for citations to articles supporting and opposing the concept of strict liability in tort.

[56] Krause, *supra* note 33, at 767-69.

[57] Hale v. Depaoli, 33 Cal. 2d 228, 201 P.2d 1 (1948).

[58] 51 Cornell L.Q. 389, 396, 401 (1965); 45 B.U.L. Rev. 289, 294 (1965).

of strict liability and abrogation of *caveat emptor* in the sales of realty are, this argument runs, essentially economic and social policy determinations most properly vested in the legislature, which has greater fact-finding ability, greater objectivity, and a more democratic decision-making process than an appeals court.

The fourth major argument relates to risk allocation, which underlies much of strict tort liability.[59] A manufacturer can bear the risks of strict liability by spreading the increased costs involved to his many consumers, "whereas a like opportunity is not available to the typical independent contractor."[60] The small building contractor is often not insured,[61] thus making him as poor a risk bearer as the owner of a house. The cost of liability insurance coverage could put a small builder-vendor in a non-competitive position; it might be just as wise, from a risk-allocation point of view, for the purchaser to insure himself.[62] Furthermore, the completed operations exclusion in many liability insurance policies may render such insurance valueless in tort suits for injuries sustained years after completion of the structure.[63]

Many of these arguments can be negatived, while others do not carry enough weight to overcome the justifications for the imposition of strict liability on builder-vendors. For example, the analogy between the manufacturer of a chattel and the builder-vendor of a structure seems quite clear. A house may contain more parts, but this is a difference of degree, not kind.[64] Both builders and manufacturers have general control over the making of their respective products;[65] both of them have a superior bargaining position vis-à-vis the individual purchaser;[66] and both of them give implied assurances of safety by placing their products on the market.[67]

The contention that a statute of limitations is rendered of no effect by imposition of strict liability is equally applicable to negligence actions, which have permitted recovery.[68] It is arguable that even if an injury is sustained several years after the completion of a house, the cause of action does not

[59] Keeton, "Products Liability—Some Observations about Allocation of Risks," 64 Mich L. Rev. 1329, 1333 (1966).

[60] Krause, *supra* note 33, at 767.

[61] 51 Cornell L.Q. 389, at 399-400.

[62] Krause, *supra* note 33, at 768 n.87.

[63] Completed operations exclusions are clauses inserted in liability insurance policies for the purpose of relieving the insurer of liability for accidents occurring after completion of work by the insured, despite the fact that the injury resulted from acts or omissions during the work.

[64] 42 Va. L. Rev. 403, 405 (1956). A more complex product may well have a greater probability of defect, but this should merely induce a higher standard of care.

[65] Dow v. Holly, *supra* note 33, at 725-26.

[66] Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69 (1960).

[67] Greenman v. Yuba, *supra* note 9, at 63-64, 27 Cal. Rptr. at 700-01, 377 P.2d at 900-01; Schipper v. Levitt, *supra* note 18, at 91, 207 A.2d at 325.

[68] See authorities cited *supra* note 57.

accrue until then, especially if the structural defect is not reasonably discoverable.[69] Then the statute of limitations would take effect.

Against the argument that the extension of strict liability to builders ought to be done, if at all, by the legislature may be weighed the fact that the doctrine of strict liability itself has been developed by courts, often drawing on the ideas of legal theorists,[70] and not by legislatures. Furthermore, there are areas within the strict liability field, such as the criteria of a "defect,"[71] which are somewhat ephemeral, do not admit of any broad, legislative definition, and thus are better handled by courts on a case-by-case basis.

The contention that builder-vendors should not be strictly liable since they may be poor risk-allocators presupposes that the goal of strict liability and risk-shifting is to spread losses as broadly as possible, both quantitatively and temporally. This assumption ignores other possible goals of risk-shifting, namely that those best able to pay ought to bear the burden of loss—the "deep pockets theory"[72]—or that enterprises whose profit-making activities lead to losses ought to bear these losses in the interest of resource allocation.[73] In addition, small manufacturers of chattels, who may also be poor risk-allocators, have not been absolved of strict liability in tort; there seems no added justification to insulate builder-vendors from liability. Finally, the completed operations exclusions in liability insurance policies have been successfully challenged,[74] thus making such coverage applicable to protect builder-vendors.

Beyond these issues, the fact is clear that the purchaser of a new home is not competent to make an inspection for structural defects, and even a skilled examiner may not be able to detect latent defects.[75] Thus, the purchaser must rely on the builder-vendor's implied representation of safety. The builder-vendor is in full control of the construction of the house[76] and therefore is in the best position to assume the responsibilty for remedying structural defects. If he reaps profits from his activities, he ought also bear the risks involved in those activities.[77] Consequently, he will use greater care to protect the lives and property of users of the home.[78] He should take

[69] White v. Schnoebelen, 91 N.H. 273, 18 A.2d 185 (1941); Rapson, "Products Liability under Parallel Doctrines: Contrasts between the Uniform Commercial Code and Strict Liability in Tort," 19 Rutgers L. Rev. 692, 707 (1965).

[70] Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69 (1960), relied on the writings of Harper and James, while the principal case relied strongly on Prosser.

[71] Sebert, *supra* note 38, at 1372-75.

[72] Prosser and Smith, *supra* note 33, at 632.

[73] See Calabresi, "Some Thoughts on Risk Distribution and the Law of Torts," 70 Yale L.J. 499 (1961) for a discussion of the goals of risk distribution.

[74] Lloyds Casualty Insurer v. McCrary, 149 Tex. 172, 229 S.W.2d 605 (1950).

[75] Bearman, "Caveat Emptor in the Sales of Realty—Recent Assaults upon the Rule," 14 Vand. L. Rev. 541, 545 (1961).

[76] Dow v. Holly, *supra* note 33, at 725.

[77] Savada v. White Motor Co., 32 Ill. 2d 612, 210 N.E.2d 182 (1965).

[78] 51 Cornell L.Q. 389, at 399.

every precaution to make the house safe for habitation, especially in view of the large investment normally entailed in the purchase of a house.

Mississippi is as yet the only jurisdiction to impose strict liability in tort on builder-vendors without qualification. Since the movement to strict liability has amounted to a "groundswell" in recent years,[79] it will not be surprising to see courts in other jurisdictions impose strict liability on builder-vendors.[80] Since, however, strict liability is based to a large extent on a defendant's superior risk-bearing or risk-allocating ability, these courts may hesitate to impose strict liability on builder-vendors who are poor risk-bearers or risk-allocators. Relevant areas of inquiry to differentiate between superior and inferior risk-bearers and risk-allocators would be the size of the builder-vendor's business, the possible degree of precision in estimating probable losses and offsetting them by insurance, and the impact of the added burden upon the builder-vendor.[81] Conclusions drawn from such inquiries may aid courts in setting guidelines for the imposition of strict liability on particular classes of builder-vendors, rather than on an all-or-nothing basis. No equal protection problem would conceivably arise, so long as the differentiation were a reasonable one.[82]

The holding in the principal case may also indicate a future expansion of strict liability to include lessors of real property. Generally, a lessor has been subject to tort liability to his lessee only for a dangerous condition of which he knew and failed to notify his lessee.[83] Since the loss-bearing ability of a lessor of realty may be as broad as that of a vendor, especially with regard to those operating on a large scale, lessors may well be held strictly liable in tort.[84]

TAXATION—BUSINESS EXPENSE DEDUCTION ALLOWED FOR SEVEN YEAR PSYCHOANALYTIC INSTITUTE—*Greenberg v. Commissioner, 367 F.2d 663 (1st Cir. 1966)*—Is a psychiatrist allowed to deduct as a business expense the costs of psychoanalytic training undertaken at a Psychoanalytic Institute? This was the question presented to the Court of Appeals for the First Circuit in *Greenberg v. Commisioner*.[1] The petitioner, Ramon M. Greenberg, was a

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79 Wade, "Strict Tort Liability of Manufacturers," 19 Sw. L.J. 5, 12 (1965).

80 This seems to be the case despite such holdings as the recent Mitchem v. Johnson, 7 Ohio St. 2d 66, 218 N.E.2d 594 (1966), which held that a purchaser's only theories of tort recovery against a builder-vendor would be negligence and misrepresentation.

81 41 Wash. L. Rev. 166, 172-73 (1966).

82 Middleton v. Texas Power & Light Co., 249 U.S. 152 (1919).

83 Prosser, Torts, 412-14 (3d ed. 1964).

84 41 Wash. L. Rev. 166, 171-72. See also Cintrone v. Hertz Truck Leasing & Rental Service, 45 N.J. 434, 212 A.2d 769 (1965), imposing strict liability on a mass lessor of chattels.

1 367 F.2d 663 (1st Cir. 1966).

practicing psychiatrist who pursued a six or seven year institute sponsored training program in psychoanalysis, upon the completion of which he would be eligible for membership in a Psychoanalytic Institute and be given recognition as a psychoanalyst. He was already a psychiatrist and free to use psychoanalytic methods in his practice.

The deduction which was available under Int. Rev. Code of 1954, section 162(a) depended upon the applicable 1954 Treasury Regulations section 1.162-5(a)(1), *Expenses for education*, which read

> (a) Expenditures made by a taxpayer for his education are deductible if they are for education (including research activities) undertaken primarily for the purpose of: (1) Maintaining or improving skills required by the taxpayer in his employment or other trade or business. . . .

Although there was the petitioner's unimpeached testimony that he took the training to improve his skills as a psychiatrist, the Tax Court refused the deduction,[2] relying heavily upon the *Namrow*[3] and *Gilmore*[4] cases for the proposition that a psychiatrist's attendance at a Psychoanalytic Institute for six or seven years of training was for the purpose of acquiring a new skill and not for improving or maintaing a skill. The court of appeals reversed the Tax Court, holding that it was not enough that psychoanalysis is a specialty, and that under the primary purpose test of the present regulations, the unimpeached testimony that the course was taken to improve skills as a psychiatrist and not to become a psychoanalyst was sufficient to allow the deduction.[5]

The importance of the case lies in the court's realization that under the regulations the acquisition of a specialty is not inconsistent with the improvement of skills required for a pre-existing profession, that the expenses of a taxpayer's educational activity are deductible if he has as his primary purpose the improvement of his skills regardless of whether he acquires a specialty or a new skill in the process. Although this is supported strongly by the language of the regulation, the Tax Court had followed previous cases[6] and refused to allow a deduction based upon a taxpayer's primary purpose. In the words of concurring Judge Withey of the Tax Court: "To me, it is unrealistic, not to say naive, to consider that in enacting § 162(a) of the 1954 Code, Congress would leave the deductibility or nondeductibility of such an expense to the mere whim of the taxpayer."[7] In part it seems to be this feeling on the part of judges which has created the difficulty in this area.

The court of appeals has clarified the area by recognizing that under the

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[2] 45 T.C. 480 (1961).

[3] Namrow v. Commissioner, 33 T.C. 419 (1959), *aff'd*, 288 F.2d 648 (4th Cir. 1961), *cert. denied*, 368 U.S. 914 (1961).

[4] Gilmore v. Commissioner, 38 T.C. 765 (1962).

[5] Greenberg v. Commissioner, *supra* note 1, at 668.

[6] *Namrow* and *Gilmore*, *supra* notes 3 and 4.

[7] 45 T.C. at 483.

existing regulations whether or not educational expenses are deductible depends upon the taxpayer's primary purpose in acquiring new knowledge, and not by the fact that in undertaking the education the taxpayer might be acquiring a new skill. It is a realization by the court that most occupations require a number of skills, that a person may improve his present status while at the same time learning a specialty. This thinking was accepted in some areas, but until *Greenberg* was rejected in regards to psychoanalysis. The decision also brings the law into agreement with cases like *Watson v. Commissioner*,[8] holding that a physician practicing internal medicine could deduct the cost of a course in psychoanalysis taken for the purpose of maintaining and improving his skills in his general practice, and *Carlucci v. Commissioner*,[9] which allowed an industrial psychologist to deduct the expenses of obtaining a doctorate. On the other hand, the decision keeps the primary purpose test which has both given the courts so much difficulty in application and also created taxpayers whose primary purpose changes the day after graduation from school.

From the cases cited above, and those mentioned by various commentators,[10] it may be seen that consistency has not been a primary concern regarding the allowance of section 162(a) expenses for education. Proposed changes in the regulations were announced by the Commissioner on July 7, 1966,[11] and again later in the year on October 1, 1966,[12] when the July proposals were withdrawn and new ones propounded. The July 7th proposals replaced the primary purpose test with a broader conception of educational expenditures. If personal or capital[13] in nature they are not deductible even though they maintain or improve skills or meet employer's requirements. Expenditures which the July 7th proposals immediately disqualified for deduction included without qualification all degree candidates, and expenses qualifying one for a new position, business, or specialty regardless of whether the individual intended to engage in the new field or advance himself.

It can be seen that the July 7 proposals would have had drastic consequences upon the deductions of internal revenue agents and accountants taking law school courses,[14] as well as many educational expenses incurred by teachers.[15] In short, the proposal would have had debilitating effects on many taxpayers seeking educational expense deductions. On the other hand, it did away with the necessity of basing a deduction on the courts' evaluation of the taxpayer's primary purpose, and at the same time would have achieved

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[8] 31 T.C. 1014 (1959).

[9] 37 T.C. 695 (1962).

[10] See Wolfman, "Professors and the Ordinary and Necessary Business Expense," 112 U. Pa. L. Rev. 1089 (1964).

[11] Proposed Treas. Reg. § 1.162-5, 31 Fed. Reg. 9276 (1966).

[12] Proposed Treas. Reg. § 1.162-5, 31 Fed. Reg. 12843 (1966).

[13] *See* Scitovsky, Welfare and Competition 189-229 (1952).

[14] Welsh v. United States, 329 F.2d 145 (6th Cir. 1964).

[15] The proposal would have written off all degree candidates regardless of other factors.

a greater uniformity of the law in this area. However, the proposal's draconic consequences apparently caused it to be withdrawn.

The revised proposals announced October 1, 1966, likewise replace the present primary purpose test with the concept that if educational expenditures are personal or capital in nature they will not be deductible although they do improve or maintain skills or meet the express requirements of either one's employer or of applicable law.[16] Two categories of nondeductible expenditures which this proposal sets up are those incurred to meet minimum educational standards and those made by an individual for education which will lead toward qualifying him for a new trade or business position or specialty. The proposal will allow the deductibility of educational expenses for maintaining or improving skills if not within the above categories. (It seems that if the new proposals are adopted, the *Greenberg* result would be foreclosed, since the expense there would definitely qualify the taxpayer for a new specialty). Thus various educational expenses which would not have been allowed under the July 7 proposals (which limited expenses which could be deducted largely to review or refresher courses) will be allowed by the October 1 proposals, and deductions will be allowed under this category for expenses for academic or vocational courses so long as they are not taken to meet minimum educational requirements or qualify one for a new trade. Likewise, under the new proposals, educational expenses incurred in meeting express requirements of the employer, or the requirements of applicable law or regulations which the taxpayer must meet in order to maintain the established employment relation will be allowed, but only if such requirements are imposed for a bona fide business purpose of the individual's employer.

The proposal restricts the deduction to the minimum education necessary to the retention by the individual of his established employment relationship, status, or rate of compensation. Thus a tenured professor could deduct expenses incurred in doing research in another country. Such education in excess could qualify under section 1.162-5(c)(2) as education taken to maintain or improve skills required by the taxpayer in his present employment.

The proposal's major changes would be to no longer allow the deduction of expenses heretofore allowable to insurance adjusters, accountants, and tax agents attending law school. Under the proposal's section 1.162-5(b)(3), these taxpayers would be qualifying for a new trade, business, position, or specialty, and thus their primary purpose in taking the law courses would no longer be relevant. Teachers, however, would be in much the same position deduction-wise as they are under present regulations. The proposal specifies in section 1.162-5(b)(2)(ii) that minimum educational requirements are to be taken as the minimum level of education (in terms of college hours or degree) which under the law in effect at the time the individual was first employed in such position, was normally required of an individual

[16] Proposed Treas. Reg. § 1.162-5, 31 Fed. Reg. 12843 (1966).

initially being employed in such a position. Then in section 1.162-5(b)(3), the proposal specifies that changes in duties, such as a change from elementary to secondary school teacher, teacher of mathematics to teacher of science, and classroom teacher to guidance counsellor, do not constitute new positions or specialties. If there are no normal requirements, the teacher will be taken to have met the requirements when admitted to the faculty. Thus, teachers remain in much the same position as they occupy presently, although certain things are perhaps spelled out more explicitly.

In addition to improving the existing law through its greater specification of what is deductible and what is not, by doing away with the primary purpose test, the proposal of October 1 seems to follow more closely the spirit and purpose of section 162(a) of the Internal Revenue Code.[17] With the aid of the new proposal the courts could truly look beyond the primary purpose of the taxpayer in the particular case to whether or not the claimed deduction was an ordinary and necessary expense proximately related to the production of the income. In this way the law in this area, which Judge Dawson of the Tax Court called "a hodgepodge of seemingly irrevocable decisions,"[18] could perhaps be clarified. With the ouster of the primary purpose test, with which the finder of fact is set "to sail on an illimitable ocean of individual beliefs and experiences,"[19] there is a much greater likelihood of uniformity and consistency.

Greenberg's abandonment of the prior distinction between the acquisition of a specialty and the improvement or maintainance of skills pointed to the necessity of change in this area. Prior cases seemed to be at odds with each other, some emphasizing the primary purpose test,[20] and others seemingly ignoring it,[21] but always trying to maintain the distinction between the improvement of skills and the acquisition of a specialty. *Greenberg's* fusion of these two categories pointed to the need for a new method of deciding upon the deductibility of educational expenses, a need which seems to have been met by the October 1 proposals.

CRIMINAL LAW—JOINT TRIALS—CONFRONTATION ISSUE—*United States v. Bozza, 365 F.2d 206 (2d. Cir. 1966)*—In *United States v. Bozza*,[1] the Second Circuit Court of Appeals reversed the convictions of those defendants whom the court found to have been prejudiced by the introduction of co-de-

[17] Int. Rev. Code of 1954, § 162(a), provides: "In general—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. . . ."

[18] 45 T.C. at 484.

[19] Commissioner v. Duberstein, 363 U.S. 278, 297 (1960), as quoted by Judge Dawson, 45 T.C. at 486.

[20] Carlucci and Watson, *supra* notes 8 and 9.

[21] Namrow and Gilmore, *supra* notes 3 and 4.

[1] 365 F.2d 206 (2d Cir. 1966).

fendant Jones' confession.[2] The trial judge had denied the co-defendants' motion for severance and had admitted the confession after deleting the names of the other defendants and after giving clear, timely instructions limiting the jurors' use of the confession to the confessing defendant alone. In holding for reversal, the court of appeals read *Delli Paoli v. United States*[3] as removing the initial barrier to appellate review by rejecting clear, timely instructions as a conclusive judicial cure for prejudicial spill-over resulting from the admission of evidence which is competent against some but not all defendants. The question arises whether the *Bozza* court's decision was permissible in light of Supreme Court decisions that have considered the problem of joint trials and cautionary instructions directly and whether in post-*Delli Paoli* decisions in analogous situations the court has not raised the question of prejudicial spill-over to a constitutional level. The most pertinent constitutional issue is the protection of a co-defendant's confrontation rights. If the reviewing court decides that cautionary instructions were ineffective in preventing the jury from using a non-judicial confession or admission of one defendant against co-defendants, then it must also find that the co-defendants injured by this spill-over were denied their confrontation rights. The reasoning is simple. *Pointer v. Texas*[4] held that every accused shall have the right to confront the witnesses against him, and that this right includes the opportunity to cross-examine the witness. A defendant may not call a co-defendant to the stand, nor comment on a co-defendant's failure to take the stand.[5] Even if the defendant who had made nonjudicial statements voluntarily took the stand, a co-defendant would be denied cross-examination as to evidence "technically" not introduced against him. The *Bozza* court in reality found a violation of the co-defendants' rights to confrontation.[6] In *Barton v. United States*,[7] the court reversed the conviction of a

[2] Nonjudicial declarations of a conspirator made during a conspiracy and in furtherance of such conspiracy are admissable, provided a foundation had been laid by independent proof for the existence of the conspiracy, as a vicarious exception to the hearsay exclusionary rule, under the rationale that each conspirator acts as an agent to each other conspirator. United States v. Gooding, 25 U.S. (12 Wheat.) 460, 469-70 (1827). However, after termination of the conspiracy, as here by arrest, the nonjudicial declarations are no longer admissible against co-conspirators but may be used against the declarant as an admission against penal interest. Krulewitch v. United States, 336 U.S. 440 (1949). See generally, Model Code of Evidence rule 508(b) (1942), Uniform Rules of Evidence 63(9).

[3] 352 U.S. 232 (1957).

[4] *Id.* at 239.

[5] In DeLuna v. United States, 308 F.2d 140 (5th Cir. 1962), *rehearing denied*, 324 F.2d 375 (1963), it was held that the defendant's attorney's repeated comment on co-defendant's failure to take the stand was reversible error, notwithstanding curative instructions, because of violation of co-defendants' 5th Amendment rights to remain silent.

[6] United States v. Bozza, *supra* note 1, at 215. In his dissent, Moore recognized the confrontation problem, but limited his discussion to the impropriety of an appellate court invading the sacrosanct of the jury room. *Id.* at 227-31.

[7] 263 F.2d 894 (5th Cir. 1959). Accord, State v. Blanchard, 44 N.J. 195, 207 A.2d 681 (1965). *But cf.* United States v. Berman, 24 F.R.D. 26 (S.D.N.Y. 1959).

defendant who had been implicated by an unsigned statement of a co-defendant which was accompanied by cautionary instructions. The court grounded its decision on the defendant's confrontation right and made no mention of *Delli Paoli*. The real issue is not whether an appellate court will find prejudicial spill-over violated an implicated co-defendant's confrontation rights, but whether a court will allow itself to find that prejudicial spill-over has occurred in the first case.

The *Bozza* court found in *Delli Paoli* a framework for analyzing a particular case to determine whether prejudicial spill-over has occurred. This framework included viewing the trial proceeding in light of five factors: (1) the simplicity of the trial proceeding, keeping in mind the number of defendants and the complexity of evidential restrictions;[8] (2) the emphasis placed on the separate interests of each defendant throughout;[9] (3) the difficulty that the jurors would have in segregating the objectionable item of evidence from the other evidence;[10] (4) the probable force of the possible spill-over in establishing the government's case against the co-defendants;[11] and (5) the presence of any indication in the record that the jury was confused or that it had failed to follow instructions.[12] The latter consideration would have been grounds for reversal even before *Delli Paoli*,[13] but the *Bozza* court was no longer willing to confine inquiry to positive examples of confusion, even though the court has found some indication of confusion in the trial record.

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8 *Delli Paoli*: conspiracy charge was of a simple nature and the part that each defendant played was easily understood, not a mass trial or one with a multiplicity of evidential restrictions. *Bozza*: there were three substantive conspiracy counts and seven substantive counts that the jury had to dispose of in various numbers as to six defendants. The trial lasted thirty days.

9 *Delli Paoli*: each defendant had separate attorneys and each attorney emphasized his client's interest. *Bozza*: this seems to have been true here also.

10 *Delli Paoli*: confession was introduced at the end of the government's case. *Bozza*: confession was introduced before testimony of an accomplice which tended to fill in the blanks and to be interwoven in the juror's minds rather than maintain a separate integrity.

11 *Delli Paoli*: force of spill-over merely cumulative on government's uncontroverted testimony implicating petitioner. *Bozza*: "Jones' confession furnished devastating corroboration of the heavily attacked testimony of an accomplice on which the prosecution almost entirely depended for proof of guilt, . . . probably ended whatever chance any of them might have had to find a juror unconvinced of his guilt beyond a reasonable doubt." 365 F.2d at 216.

12 *Delli Paoli*: no evidence in the record of possible confusion. *Bozza*: the record disclosed that the jury requested Jones' confession and they had it physically present during their deliberations. The court felt that the jury would not have wanted this confession in considering solely the case against Jones.

13 No cases were discovered that found that the record revealed confusion on the part of jurors and reversed solely for that reason. However, it would seem logical that if confusion was found in the record, reversal would be appropriate. There is much dicta to that effect. *E.g.*, Meredith v. United States, 238 F.2d 535 (4th Cir. 1958).

In considering the problem of prejudicial spill-over, the question that must be answered is the amount of justifiable reliance which can be placed on the efficacy of limiting instructions in joint trials to preserve the rights of co-defendants. Assuming reliance upon instructions would be justifiable in one class of cases and not justifiable in another, it seems appropriate to consider joint trials and the various problems they present to determine what elements should be influential in deciding in which class a particular case should fall. A defendant in a joint trial may be prejudiced in two distinct ways. In some situations a general atmosphere of confusion arises which may pose due process questions; in other situations positive evidence is admitted against one defendant which implicates co-defendants and brings the confrontation rights of the co-defendants into question. In most cases a joint trial is not as advantageous to the individual defendant as a separate trial would be. The real question is whether the social interest in having joint trials justifies the relative disadvantages to the accused. The social interest in permitting joint trials is that they are a logical method of avoiding unnecessary duplication in prosecuting defendants for acts arising out of the same general fact situation and calling for basically the same evidence. The social value is a saving of the time and energy of its public servants.[14] The savings would be greater in the federal system where criminal acts are usually long-term, complicated activities involving many people and lacking in the clear indicia of criminal behavior which is more often found in isolated, violent criminal acts that are the subject of most state prosecutions. Joint trials also save expense because venue may be more advantageously set.[15] Whatever weight these social advantages may have in balancing the state's interest in having joint trials against a defendant's contentions that the general atmosphere of a trial situation was unfair, it would seem that these considerations of the social advantages would be irrelevant where the infringement of a clearly defineable constitutional guarantee, more particularly, the right of confrontation, is urged.

Some of the advantages that a joint trial provides the prosecutor are not based on social justification but are the tolerated by-products. In the eyes of the prosecutor the real advantage of the joint trial may result from these undesired effects which create a more favorable atmosphere for conviction. Each defendant, by his efforts to shift the responsibility, may assist the prosecutor in proving his case against the other defendants. Thus, as a practical matter, each defendant must not only repel the government's evidence but also the shadings and contradictions contained in the testimony of his co-defendants who are attempting to cast the major responsibility on someone else.[16] The prosecutor may also gain the advantage of prejudicial spill-over of the evidence where limiting instructions are ineffectual. These

[14] United States v. Maine Lobsterman's Ass'n, 160 F. Supp. 115, 120 (D. Me. 1957).

[15] Brown v. Elliot, 225 U.S. 392 (1912). See Levi, "Hearsay and Conspiracy," 52 Mich. L. Rev. 1159 (1948).

[16] DeLuna v. United States, *supra* note 5.

advantages are most apt to accrue in joint prosecutions for conspiracy because conspiracy implies involvement of more than one actor; to prove the case against one defendant the prosecutor must be allowed to introduce evidence implicating others.[17] In theory, the prosecutor has an equal amount of evidence whether the defendants are joined or separately tried; in fact, however, the prosecutor has decided advantages at the expense of the defendants by having a joint trial.[18] On the other hand, a defendant in a joint trial must attempt to preserve a separate and distinct identity in the minds of the jury. If he fails to maintain a distinct identity, he may suffer a conviction based upon evidence which is theoretically incompetent against him. His ability to maintain his separate identity becomes more difficult when a general atmosphere of confusion is created and dangers of guilt by association come into play. This general confusion may occur when defendant is joined with others whose own interests tend to dominate the proceeding. The number and type of co-defendants are important factors in determining whether the jury can mentally segregate each defendant for individual determination. Where seventy-five defendants are joined,[19] or where five of fourteen co-defendants have the same surname,[20] it is difficult to believe, in such a confusing atmosphere, that any individualized consideration by the jurors is possible. Even where the number of defendants joined is reasonable, the characteristics of a particular defendant may dominate the trial proceeding, for example, where one defendant is being tried for a much more serious offense[21] or where one defendant has had adverse pre-trial publicity.[22]

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17 Lutwak v. United States, 344 U.S. 604, 623 (1953) (Jackson, J., dissenting) "But one of the additional leverages obtained by the prosecution through proceedings as for conspiracy instead of as for the substantive offense is that it may get into evidence against one defendant's acts or omissions which color the case against all". In Krulewitch v. United States, 336 U.S. 440, 457 (1949), Justice Jackson, in a concurring opinion, stated "I think there should be no straining to uphold any conspiracy conviction where prosecution for the substantive offense is adequate and the purpose served by adding the conspiracy charge seems chiefly to get procedural advantages to ease the way for conviction."; Levi, *supra* note 15, at 1174 "(Post-conspiracy declarations) look impressive and the fine point of restricting admissions to the party who made the declaration is often lost on a jury." Levi noted that there are an increasing number of conspiracy prosecutions in lieu of substantive offense because of the practical advantages gained by the prosecutor. In the Conference of Senior Circuit Judges, Annual Report of Attorney General, 5-6 (1925), there was expressed a growing concern of the use of conspiracy prosecutions "with the effect of bringing in much improper evidence."

18 In his dissenting opinion in *Delli Paoli*, Frankfurter wrote, "The Government should not have the windfall of having the jury be influenced by evidence against a defendant which, as a matter of law, they should not consider but which they cannot put out of their minds." 352 U.S. at 248.

19 Allen v. United States, 4 F.2d 688 (7th Cir. 1924), *cert. denied*, Mullen v. United States, 267 U.S. 598 (1925). *See also* "Recent Developments in the Law—Criminal Conspiracy," *supra* note 15, at 980.

20 Scarborough v. United States, 232 F.2d 412 (5th Cir. 1956) (reversing for tardy instructions).

21 Arguments that co-defendant was indicted for a more serious offense rejected as

In some cases hostility between co-defendants adds an additional element of confusion into the proceeding.[23] Under the recent amendment to Rule 14,[24] the federal judge can consider the prosecutor's entire case when a motion for severance is made; this motion would usually be made long before trial. It would seem that a defendant should have a separate trial where a joint trial would present a possibility of general confusion unless the government bears the burden of showing that there would be a substantial savings in time and money with minimal detriment to any defendant.

Perhaps the most dangerous situation, one which raises confrontation problems, is where the jury cannot or will not restrict evidence of limited admissibility to the dictates of the accompanying instructions. The prejudice that may occur in this situation is not one of general confusion, but instead, it involves the possibility of prejudicial spill-over of definite evidence tending to establish the criminal participation of the implicated co-defendants. The nonjudicial admissions or confessions of co-defendants are the most serious variety of such evidence because of the great likelihood that they will impress the jury. The confession is allowed to come in at the trial as an admission against the interest of the confessor.[25] It is felt that one would

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ground for severance in United States v. Sherman, 84 F. Supp. 130 (E.D.N.Y. 1947), *affirmed in part and reversed in part*, 171 F.2d 619 (2d Cir. 1948); *cf.* McDonald v. United States, 89 F.2d 128 (8th Cir. 1937) (co-defendant handcuffed during trial).

[22] Arguments for severance based on the pre-trial publicity of a co-defendant were rejected in United States v. Hoffa, 205 Supp. 710 (S.D. Fla.), *cert. denied*, 371 U.S. 892 (1962). *But cf.* United States v. Marshall, 360 U.S. 310 (1959) where the jurors had been exposed to inadmissible evidence from the newspaper. Each individual juror promised the trial judge that he would disregard this information. The Supreme Court reversed.

[23] Argument that hostility among co-defendants was ground for severance was rejected in Goodman v. United States, 273 F.2d 853 (8th Cir. 1960).

[24] The amendment to Fed. R. Crim. P. 14 is "In ruling on a motion by a defendant for severance the court may order the attorney for the government to deliver to the court for inspection in *camera* any statement or confessions made by the defendant which the government intends to introduce in evidence at the trial." See 8 Moore, Federal Practice 14.04 (2) at 14-14 (2d ed. Supp. 1966), "Examination of statements or confessions *before* trial is likely to increase the number of severances since the desire of the court to "save" a trial once it has commenced is not present. e.g., Belvin v. United States, 273 F.2d 583, 587 (5th Cir. 1960), *cert. denied*, 372 U.S. 922 (1963). Pre-trial examination will permit the court to determine, for example, whether excision of references to the non-declarant defendant is impracticable. A determination of impractability should weigh heavily in favor of severance. The Advisory Committees' citation of Fifth Circuit cases requiring severance suggests that the new provision should be liberally interpreted." The burden of showing prejudice has previously been on the defendants; *e.g.*, Hall v. United States, 168 F.2d 161 (D.D.C.), *cert. denied*, 334 U.S. 853 (1948); United States v. Haim, 218 F. Supp. 922, 931 (S.D.N.Y. 1963); United States v. Abrams, 29 F.R.D. 178, 181 (S.D.N.Y. 1961). It is suggested that this amendment places the burden on the government to show that joinder would not be prejudicial. 8 Moore, *supra* at ¶ 14.02[1] at 14-3.

[25] Opper v. United States, 348 U.S. 84 (1954). *See* Model Code of Evidence rule 509 (1942).

not admit to activities which may give rise to penal sanctions unless they were true. Thus, non-judicial confessions are felt to have a satisfactory degree of trustworthiness as far as they describe the activities of the confessor. Furthermore, the confessor is in court and can take the stand to clarify or otherwise protect himself from the confession being improperly used. However, such guarantees of trustworthiness do not accompany statements implicating others.

> Declarations made after the conspiracy ends are particularly untrustworthy. Once the conspiracy terminates, the interest of every member is to avoid responsibility and shift the blame. What he says about himself by way of an admission or confession may well be true and is, at any rate, against his own interest. But what he says about others may be based on spite, fear, pique, malice, or desire to stand well with the prosecutor or many other motives not leading to truth.[26]

Courts have attempted to delete statements implicating defendants from nonjudicial admissions of co-defendants. Sometimes deletion is not possible without rendering the item of evidence meaningless. Even where references to non-confessing defendants can be deleted, subsequent testimony may fill in the missing pieces. When this happens, deletion may actually have the opposite effect. Having had their curiosity excited, the jury may be more likely to use the evidence against those defendants whose "secret identity" had been discovered.[27] However, where the deleted references cannot be discovered, directly or indirectly, the defendants are protected from possible prejudicial spill-over. Where deletion is not possible and evidence of limited admissibility is presented, limiting instructions must be given.

It may be valuable to distinguish limiting instructions in the multi-defendant situation from limiting instructions in the single defendant situation. The purposes they serve in the two situations are sometimes different. In general, limiting instructions seem to be a prerequisite of a legal system which hopes to preserve both trial by jury and those policies that require certain information be kept from the jury to secure a fair trial for the parties. Because the characteristics of a proffered item of evidence may not be readily

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[26] Levi, *supra* note 15 at 1173.

[27] In Malinski v. New York, 324 U.S. 401 (1945), the Court affirmed a conviction of a non-confessing co-defendant where an "X" was substituted for his name. In dissenting, Justice Rutledge wrote "The devices were so obvious as perhaps to emphasize the identity of those they purported to conceal" 324 U.S. at 430. Compare Comments, "Post-conspiracy Admissions in Joint Prosecutions—Effectiveness of Instructions Limiting the Use of Evidence to A Co-Defendant," 24 U. Chi. L. Rev. 710, 713; "It seems reasonable that a jury will follow many instructions, but it does not follow that it is reasonable to expect a jury to obey instructions to disregard relevant evidence. Research by the Jury Project at the University of Chicago Law School tends to support the widely held suspicion of trial lawyers that such an instruction only serves to make the forbidden evidence weigh more heavily in jurors' minds, even though they may consciously attempt to follow the instructions."

apparent, the trial judge cannot always be expected to make a proper determination in the first instance. To preserve the policies embodied in the rules of evidence and the jury trial, the judge may have to give corrective instructions and, within limits, the jury must be relied on to follow his instructions.[28] In joint trials, the judge uses limiting instructions for the additional purpose of protecting defendants from prejudicial spill-over. Where evidence is admissible against less than all the joined defendants, it is inadmissible by definition against some defendants. There is little chance that the status of such evidence will change as the trial progresses. The trial judge must only decide whether the potential prejudice can realistically be neutralized by the accompanying instructions. In deciding whether the prejudicial spill-over can be effectively neutralized, the judge should consider the logical, moral, and psychological difficulties that limiting instructions may raise in the joint trial situation. Limiting instructons often require illogical thinking. "It (the jury) cannot find that a confession is true as it admits that A commited criminal acts with B and at the same time ignore (as the jury is told to) the inevitable conclusion that B has committed those same criminal acts with A."[29] Because of the logical difficulties, the use of limiting instructions to prevent spill-over may be morally questionable. Without understanding the policies surrounding the use of limiting instructions, the jurors must wonder how just is a legal system that demands of them "a violence to all our habitual ways of thinking. . . ."[30] Jurors are sincere, conscientious people who come to serve with an expectation of a fair tribunal. If instead of meeting their expectations, the judicial process presents them with apparently

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[28] "Our theory of trial relies upon the ability of a jury to follow instructions." Opper v. United States, *supra* note 25, at 95. In his dissenting opinion in Bozza, Moore stressed the need to rely on the jurors' ability to follow instructions. "The very nature of our method of developing facts by examination of witnesses requires this assumption. All witnesses cannot testify simultaneously. Each tells of the facts known to him—facts which frequently are quite fragmentary . . . . Thus, testimony must be accepted subject to connection or to motion to strike if some future witness does not supply the connecting link. Yet the jury had heard the testimony which has reached, and made a permanent impression on, the jury mind. . . . . Rarely in a trial of any duration are there not countless incidents which require and receive such court instruction and admonition. 365 F.2d at 228.

[29] People v. Aranda, 63 Cal. 2d 518, 529, 407 P.2d 267, 272, 47 Cal. Rptr. 353, 360 (1965).

[30] United States v. Delli Paoli, 229 F.2d 319, 321 (2d Cir. 1956) (L. Hand, J.), *aff'd* 352 U.S. 232 (1957); People v. Aranda, *supra* note 29 at 526, 407 P.2d at 269, 47 Cal. Rptr. at 357. "The rule (that the jury must always be presumed to follow instructions) is not basic to our jury system. Instead, it is a rule that perverts the jury trial since it calls upon ordinary lay people to obey an instruction that every judge realizes cannot be obeyed. It fosters what one scholar refers to as our 'inconsistent attitudes' toward juries. We treat them at times as a group of low-grade morons and 'at other times as men endowed with a superhuman ability to control their emotions and intellects' (Morgan, Some Problems of Proof under the Anglo-American System of Litigation (1956) p. 105.)"

unreasonable technicalities, the legal system will suffer a loss in dignity. The jurors may rebel at the task and refuse to follow the instructions. Even where the jurors would be willing to follow instructions, they may be psychologically unable to do so. Much judicial response has been directed at this violation of the epistemic condition of admissibility. "Exposed to the realities of depth psychology, judicial cliches carving jurors' minds into autonomous segments may waiver and fail."[31] Judge Learned Hand called this use of limiting instructions "the recommendation to the jury of mental gymnastic which is beyond, not only their powers, but anybody else's."[32]

In light of the discussion of the dangers of untrustworthiness that the implicating portions of a co-defendant's non-judicial confession may present, the weaknesses found in the use of limiting instructions to prevent the apparently reliable implicating remarks from spilling over on the implicated co-defendants, and the confrontation problems such a procedure seems to raise, it seems important to consider how the Supreme Court has dealt with this problem. In *Delli Paoli*, the Court reaffirmed its faith in the jury system and warned against appellate courts engaging in "unfounded speculation that the jurors disregarded clear instructions of the court in arriving at their verdict."[33] However, the Court also stated "There may be practical limitations to the circumstances under which a jury should be left to follow instructions, but this case does not present them."[34] and "Unless we proceed on the basis that the jury will follow the court's instructions where those instructions are clear and *the circumstances are such that a jury can reasonably be expected to follow them, the jury system makes little sense.*"[35] Thus, the majority indicated that clear instructions cannot be relied on in all cases. In support of its holding, the Court in *Delli Paoli* cited earlier federal cases, none of which suggest that the determination is to be made on a constitutional basis.[36] The major supporting cases were *Blumenthal v. United States*,[37] *Lutwak v. United States*,[38] and *Opper v. United States*.[39] None of

[31] People v. Chambers, 231 Cal. App. 2d 23, 33, 41 Cal. Rptr. 551, 558 (1966).

[32] Nash v. United States, 43 F.2d 1006, 1007 (2d Cir.), *cert. denied*, 285 U.S. 556 (1932). The court of appeals affirmed the convictions on the grounds that this area should be left to the trial judge's discretionary powers. Hand also indicated that such prejudicial effect may further rather than impede the search for truth. 54 F.2d at 1007.

[33] Delli Paoli, *supra* note 3, at 242 (quoting *Opper v. United States*, *supra* note 25 at 95).

[34] *Id.* at 243.

[35] *Id.* at 242 (Emphasis added).

[36] *Cf.* Leland v. Oregon, 343 U.S. 790, 800 (1952) in which the Court rejected arguments that instructions would confuse the jury as to distinction between the state's burden of proving premeditation and the other elements of the change and appellant's burden of proving insanity. *See* Jackson v. Denno, 378 U.S. 368, 427 (1964) (Harlan, J., dissenting).

[37] 332 U.S. 539, *rehearing denied*, 332 U.S. 856 (1947), affirming the convictions of four petitioners jointly tried with another defendant for conspiring above the ceiling set by the regulations of the Office of Price Administration, in violation of the Emergency Price Control Act.

these cases contained compelling language indicating that the jury must be presumed to follow clear instructions in all cases. In *Blumenthal*, the Court stressed the danger that the jury might consciously or unconsciously transfer the effect of the evidence to those defendants against whom the evidence is incompetent. "It is therfore extremely important that those safeguards (against the improper use of evidence by the jury) be made as impregnable as possible."[40] However, the Court held that there were none of the common risks of prejudice presented in the particular proceeding. There were only five defendants charged with a single count in an uncomplicated proceeding. The Court also held that the unobjectionable evidence was sufficient to support a conviction. In *Lutwak*, the majority held that the use of one item of inadmissible hearsay did not call for reversal where the record "fairly shrieks the guilt of the parties."[41] The dissent in *Lutwak* considered other evidence that had been accompanied by limiting instructions and observed that "much of such evidence was of such remote probative value, and the instruction limiting its use so predictably ineffectual that its admission violated a substantial right of those defendants,"[42] because no jury could perform the task called for in the instructions. Thus, the majority in *Lutwak* dealt with the issue of the jury's ability to follow instructions only by its silence. In *Opper v. United States*, the Court gave little weight to the petitioner's claim of prejudicial spill-over and indicated that the petitioner had raised only a "general possibility of confusion" but pointed out nothing specifically prejudicial resulting from the joint trial."[43] The Court also found substantial competent evidence upon which the jury could have found the petitioner guilty. Each of these three cases looked to the competent evidence against the petitioner. If the competent evidence would have been adequate to find the petitioner guilty, the prejudice was harmless. The *Bozza* court, however, adopted a different standard of plain error, "The test is whether belief 'is sure that the error did not influence the jury or had but very slight effect' —even if that be the standard in area with 'grave constitutional overtones.' "[44]

Despite these prior decisions in point, other Supreme Court decisions

[38] 344 U.S. 604 (1953), affirming the convictions of three jointly tried defendants for conspiracy to defraud the United States by obtaining illegal entry of three aliens under the War Brides Act by means of sham marriages.

[39] 348 U.S. 84 (1954), affirming the conviction of a federal employee charged with violating 18 U.S.C. § 281 by agreeing to receive compensation from a co-defendant.

[40] Blumenthal v. United States, *supra* note 37, at 559-60.

[41] Lutwak v. United States, *supra* note 38, at 619.

[42] *Id.* at 623.

[43] Opper v. United States, *supra* note 39 at 94.

[44] United States v. Bozza, *supra* note 1, at 218. "To be sure the evidence apart from Jones' confession was ample for conviction on all counts if the jury believed Kuhle, as we have relatively little doubt it would have even without the impressive corroboration which the confession furnished. However, it is not that 'the jury would have in all probability returned a verdict of guilty' against the other defendants without knowledge of Jones' confession, which they were forbidden to possess." *Ibid.;* See also Fed. R. Crim. P. 52.

following *Delli Paoli* may have raised the question of prejudicial spill-over to one of constitutional dimensions. In *Jackson v. Denno*,[45] the court held that it was a violation of due process to require the convicting jury to determine both the voluntariness and weight to be given a confession. The Court felt that the jury could not be trusted to disregard an involuntary confession which it also found to be truthful. The Court asked rhetorically:

> If (the jury) finds the confession involuntary, does the jury—indeed, can it—then disregard the confession in accordance with its instructions? If there are lingering doubts about the sufficiency of other evidence, does the jury unconsciously lay them to rest by resorting to the confession? Will uncertainty about the sufficiency of the other evidence to prove guilt beyond a reasonable doubt actually result in acquittal when a jury knows the defendant has given a truthful confession?[46]

The Court held that the jury could not. Similar questions arise in the *Bozza* situation. Can a jury be expected to use a co-defendant's truthful confession or admission to convict him and then disregard the same confession in considering the guilt or innocense of the co-defendants whom the confession has implicated? Perhaps the *Bozza* situation presents an even stronger case for striking down a trial procedure than the procedure considered in *Jackson*. In comparing the two situations, Chief Justice Traynor wrote:

> Under the New York procedure, which *Jackson* held violated due process, the jury was only required to disregard a confession it found to be involuntary. If it made such a finding, then the confession was presumably out of the case. In joint trials, however, when the admissible confession of one defendant inculpates another defendant, the confession is never deleted from the case and the jury is expected to perform the overwhelming task of considering it in determining the guilt or innocence of the declarant and then of ignoring it in determining the guilt or innocence of any co-defendant of the declarant.[47]

However, the *Bozza* court avoided the question, "Without going so far as to say that the logic of Jackson v. Denno . . . necessarily removes any basis for relying on an instruction to limit the damaging effects of a confession implicating a co-defendant. . . ."[48] Nevertheless, in comparing *Jackson* and *Delli Paoli*, Justice Harlan in a dissenting opinion in *Jackson* observed:

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[45] 378 U.S. 368 (1964).

[46] *Id.* at 388.

[47] People v. Aranda, *supra* note 29, at 529, 407 P.2d at 271-72, 47 Cal. Reptr. at 359-60. Although Traynor had "grave constitutional doubts of permitting joint trials where the confession of one defendant implicates co-defendants," the opinion did not decide on a constitutional basis. "Whether or not it is constitutionally permissible, the practice if prejudicial and unfair to the nondeclarant defendant and must be altered." *Id.* at 530, 407 P.2d at 272, 47 Cal. Rptr. at 360.

[48] United States v. Bozza, *supra* note 1, at 217.

> But was there not greater danger in *Delli Paoli* that one defendant's confession of his and his codefendants' guilt would infect the jury's deliberation bearing on the guilt of the codefendants? And was it not more 'difficult, if not impossible' for jurors to lodge the evidence in the right mental compartments in a trial of five defendants than here, in a trial of one.[49]

The recent case of *Spencer v. Texas*[50] seems to give weight to the proposition that the similarities of the problem in *Jackson* and *Delli Paoli* may foreshadow a holding that the *Delli Paoli* procedure violates due process.[51] The problem in both cases is the scope of reliance that can be placed on the jury's ability to comply with the legal safeguards provided by instructions where a specific constitutional right may be substantially threatened if this judicial cure fails. Whether or not this judicial cure has failed remains hidden behind the general verdict. In *Spencer*, the petitioners relied solely on a *Jackson*-type argument to attack a procedure that permitted the jury to consider evidence of prior convictions during the guilt-determining stage of the trial. The evidence of prior crimes did not fall within any of the historic exceptions to the exclusionary rule for hearsay and was introduced solely for the purpose of determining whether there had been prior convictions. This determination would affect the selection of penal sanctions under habitual offender statutes. The Court rejected this *Jackson*-type argument and held that it would be a wholly unjustified encroachment by the Court to promulgate rules of evidence for the state *so long as their rules are not prohibited by any specific provision of the Constitution.*[52] Thus the Court announced that a *Jackson* approach to cautionary instructions, an approach that would not permit a jury to be guardian of a constitutionl right where the temptation to disregard their duty is present, would only be appropriate where the protection of a *clearly defineable* constitutional right is needed.

> [T]he emphasis there (in *Jackson*) was on protection of a specific constitutional right, and the *Jackson* procedure was designed as a specific remedy to ensure that an involuntary confession was not in fact relied upon by the jury. In the procedure before us, in contrast, no specific federal right—such as that dealing with confessions—is involved; reliance is placed solely on a general "fairness" approach. In this area the Court has always moved with caution before striking down state procedures.[53]

Such protection of a specific constitutional right is also needed where the confession or admission of one defendant may directly implicate co-defen-

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[49] Jackson v. Denno, *supra* note 45, at 434-35. (Dissenting opinion.)

[50] 87 Sup. Ct. 648 (1967).

[51] "The Supreme Court, 1963 Term," 78 Harv. L. Rev. 143, 213 n.25 (1964) finding significance in the fact the Court in *Jackson* quoted from Frankfurter's dissent in *Delli Paoli.*

[52] Spencer v. Texas, *supra* note 50 at 656.

[53] *Id.* at 654.

dants. The only protection provided for the implicated co-defendant's specific guarantee of confrontation is the jury's obedience to cautionary instructions. The temptation to flaunt the instructions or unconsciously disregard them is present. Thus it would seem a *Jackson*-type analysis is appropriate to prohibit trial procedures that permits such implicating evidence to be admitted. In other joint trial situations, where the prejudice results from a general atmosphere of confusion rather than the admission of any positive implicating evidence, no specific constitutional guarantee will be threatened, but only the more nebulous notions of due process fairness. In these situations a *Jackson* approach seemingly will not be employed by the Court. The reviewing courts can probably continue to rely on the trial judge's discretion in permitting joint trials where the possibility of prejudice of this general nature might occur.

If the Supreme Court does find that the introduction of evidence of limited admissibility in joint trials which might have a spill-over effect violates the Constitution, prosecutors who hope to conduct joint trials will be required to keep out non-judicial declarations of one defendant that implicate co-defendants. If the inferences contained in such declarations can be completely removed, there will be no need for cautionary instructions and no threat to co-defendants' confrontation rights. The prosecutor may introduce the declarations safely. However, if the implicating effect cannot be removed, a prosecutor must either refrain from using such evidence or try the confessing defendant separately. The practical effect would be to allow joint trials, but only where the defendants are accorded some of the safeguards they would have had had they been separately tried. In light of the recent amendment to Rule 14, there would seem to be no great burden on the trial judge in the federal system to comply with this possible constitutional standard at the pre-trial stage; the issue may arise at a latter stage of the proceedings in state courts when the prosecutor seeks to introduce the objectionable evidence because of the absence of effective pre-trial discovery procedures for defendants. The continuation of the co-conspirators exception to the hearsay exclusionary rules may also be subject to attack. If the Court does not establish a conclusive presumption of a confrontation violation where there is implicating evidence accompanied by cautionary instructions, but instead sanctions a *Bozza*-type approach in which various elements in the trial setting are scrutinized to determine whether prejudicial spill-over has occurred, there will still be important advantages to the co-defendants who argue that a violation of their confrontation rights took place. They would have a new basis for federal jurisdiction[54] and would have the question of prejudicial spill-over considered without looking to the sufficiency of other evidence to render "harmless" a violation of a defendant's confrontation rights.[55]

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[54] Comment, 13 U.C.L.A.L. Rev. 366, 379 (1965).

[55] Jackson v. Denno, *supra* note 45 at 383, "The danger that matters pertaining to defendant's guilt will infect the jury's findings of fact bearing upon voluntariness, is sufficiently serious to preclude their unquestioned acceptance regardless of whether there is or is not sufficient other evidence to sustain a finding of guilt."

CONSTITUTIONAL LAW—FREE EXERCISE OF RELIGION—DENIED AS A DEFENSE TO NARCOTICS CHARGE—*State v. Bullard, 267 N.C. 599, 148 S.E.2d 565 (1966)*—In 1966, in *State v. Bullard*,[1] the North Carolina Supreme Court sustained a conviction for unlawful possession of narcotics. Defendant argued that peyote and marijuana were not narcotics, and their possession was lawful. The court denied this defense because the statutory definition of narcotics included peyote and marijuana, and expert testimony characterized the two drugs as narcotics.[2] Regarding the defendant's major defense that he was a Peyotist to whom the use of the drugs was necessary in the practice of his religion, the court held that, even if the defendant was sincere in his religious belief, the first amendment could not protect him. While the amendment permitted him complete freedom of religion in that he could belong to any church or to no church and could believe whatever he wanted, however fantastic, illogical or unreasonable, it did not authorize him in the exercise of his religion to commit acts which constituted threats to the public safety, morals, peace and order.[3] Defendant's constitutional rights were not violated when he was forbidden, despite his religion, possession of drugs which produce hallucinatory symptoms.[4]

Obviously, the basis for any defense on religious grounds must be found in the first amendment. Yet the simple words, "Congress shall make no law respecting an establishment of religion or prohibiting the free exercise thereof,"[5] do not say much without judicial interpretation. It is generally recognized that the framers of the Constitution were greatly influenced by the natural rights theory,[6] which viewed the individual as possessing certain indefeasible primary rights which should be protected against governmental intrusion or group encroachment. Religious freedom was considered to be one such right. However, a "right" may have many explanations, ranging from immunity, characterized by complete absence of government restrictions, to privileges, which the government may or may not allow.[7] The prevailing concept has been that the first amendment neither takes away nor abridges any power of the government, but makes express the absence of power.[8] Yet this immunity principle cannot be literally applied because a government must be able to restrict some types of religious activities to preserve a society where freedom of religion can exist.[9]

A practical solution to the immunity dilemma was presented by the Supreme Court in *Reynolds v. United States*,[10] in which a federal antibigamy

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1 267 N.C. 599, 148 S.E.2d 565 (1966).

2 *Id.* at 601, 148 S.E.2d at 567.

3 *Id.* at 603-04, 148 S.E.2d at 568-69.

4 *Id.* at 604, 148 S.E.2d at 569.

5 U.S. Const. amend. I.

6 Pfeffer, Church, State and Freedom 91 (1953).

7 Pollack, "Natural Rights: Conflict and Consequence," 27 Ohio St. L.J. 559, 560 (1966).

8 Pfeffer, *supra* note 5 at 115.

9 Pollack, *supra* note 6 at 561-62.

10 98 U.S. 145 (1878).

statute was upheld.[11] To defendant's claim of exception from the statute because the religious tenets of the Mormon church required the practice of polygamy, the Court answered that the first amendment did not protect such religious practices:

> Congress was deprived of all legislative power over mere opinion, but was left free to reach actions which were in violation of social duties or subversive to good order. . . . Laws are made for the government of actions, and while they cannot interfere with mere religious belief and opinions, they may with practices.[12]

Originally the first amendment was held not applicable to the states.[13] However, state courts followed *Reynolds* in cases which involved religious defenses under state constitutions, and decided such cases on the basis of the distinction between religious belief or opinion and action.[14] Where a state enforced a regulation, the purpose of which in the general community estimation was non-religious, exemption on religious grounds was denied.[15] The first amendment was first held applicable to the states through the fourteenth amendment in *Cantwell v. Connecticut*,[16] which case expanded the *Reynolds* test to include balancing state regulatory interests against religious interests:

> The Amendment embraces two concepts—freedom to believe and freedom to act. The first is absolute but, in the nature of things, the second cannot be. Conduct remains subject to regulation for the protection of society. The freedom to act must have appropriate definition to preserve the enforcement of that protection. In every case the power to regulate must be so exercised as not, in attaining a permissible end, unduly to infringe the protected freedom.[17]

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[11] The Court found that polygamy had always been odious to our culture and an offense against society punishable by the civil courts, and considered polygamy as a threat to democratic institutions. *Id.* at 166-67.

[12] 98 U.S. at 164, 166.

[13] Permoli v. New Orleans, 44 U.S. (3 How.) 589 (1845), which held that an infringement of religious liberty by a state was a matter for the state itself under the state constitution or laws.

[14] *E.g.*, Delk v. Commonwealth, 166 Ky. 39, 178 S.W. 1129 (1915); McMasters v. State, 21 Okla Crim. 3, 8, 207 Pac. 566 (1922); State v. Marble, 72 Ohio St. 21, 73 N.E. 1063 (1905).

[15] *E.g.*, Dunham v. Board of Education, 154 Ohio St. 469, 96 N.E.2d 413 (1951), *cert. denied*, 341 U.S. 915 (1951); State v. Powell, 58 Ohio St. 324, 50 N.E. 900 (1898).

[16] 310 U.S. 296 (1940).

[17] *Id.* at 303, 304. Subsequent cases do not show any clear guidelines but only the results of case by case adjudication. Religious claims were denied because a municipality had authority to impose regulations to assure the safety and convenience of the people in the use of public highways. Cox v. New Hampshire, 312 U.S. 569 (1941). The state's interest in the health and welfare of a child was found to be superior to the parents' and child's religious scruples. Prince v. Massachusetts, 321 U.S. 158 (1944). Cursing a public officer was not an exercise of religion. Chaplinsky v. New Hampshire 315 U.S. 568 (1942).

Further guidelines were set out in *Sherbert v. Verner*,[18] which reversed a state court's determination that a Seventh-day Adventist, whose religion prohibited Saturday work, was ineligible for unemployment benefits because of her unavailability for employment. The Supreme Court held that denial of benefits was the same type of a burden on the free exercise of religious observance as a fine imposed for Saturday worship.[19] It further held that a state cannot, unless justified by a compelling state interest in the regulation of a subject, condition public benefits, whatever their purpose, so as to inhibit or deter first amendment freedoms. Merely showing a rational relationship to some colorable state interest is insufficient; only the gravest abuses, endangering paramount interests, give occasion for permissible limitations.[20] The state must demonstrate that alternative forms of regulation would be ineffective.[21] Different results may be reached only where exemption on religious grounds would be of such magnitude as to render the entire statutory scheme unworkable.[22]

In 1964, the California Supreme Court applied the *Sherbert* guidelines in *People v. Woody*,[23] holding that the state cannot constitutionally apply a statute proscribing the use of peyote to prevent Indians from using it in their religious ceremonies. The court specifically held that *Sherbert* called for a determination of (1) whether the application of the statute[24] imposes any burden upon the free exercise of the defendants' religion, and (2) if it does, whether some compelling state interest justifies the infringement.[25] In *Woody*, a burden was imposed because peyote was an object of worship and denial of its use would result in a virtual inhibition of the practice of the defendants' religion.[26] The state's claim that compelling reasons for prohibition of Peyotism were its deleterious effects upon the Indian community and extensive problems in the enforcement of state narcotics laws caused by the difficulty of detecting fraudulent claims of religious use of peyote was found by the court to be unsupported by facts.[27] The court distinguished *Reynolds* stating (1) that polygamy, a basic tenet in the theology of Mormonism, is not essential to practice of the religion, whereas peyote is essential to Peyotism, because without it the defendants are unable to experience or

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[18] 374 U.S. 398 (1963).

[19] *Id.* at 404.

[20] *Id.* at 406.

[21] *Id.* at 407. *See* Braunfeld v. Brown, 366 U.S. 599 (1961), where exemption for Sabbatarians appeared to present too many administrative problems.

[22] *Id.* at 408. Subsequently the Court vacated a judgment against a juror convicted for refusal to serve on jury because of her religious belief against judging others, and remanded the case for further consideration in light of *Sherbert*. *In re* Jenison, 375 U.S. 14 (1963).

[23] 61 Cal. 2d 716, 394 P.2d 813, 40 Cal. Rptr. 69 (1964).

[24] Cal. Health & Safety Code § 11500.

[25] 61 Cal. 2d at 719, 394 P.2d at 816, 40 Cal. Rptr. at 72.

[26] *Id.* at 722, 394 P.2d at 818, 40 Cal. Rptr. at 74-75.

[27] *Id.* at 722-23, 394 P.2d at 818-19, 40 Cal. Rptr. at 75.

practice their religion; and (2) that the degree of danger to state interests in *Reynolds* far exceeded that in *Woody*.[28]

Thus we have *Bullard* and *Woody*, two somewhat parallel recent cases questioning the relation between free exercise of religion under the first amendment and enforcement of a state's drug control laws, but reaching different results. Ostensibly, the differing results may be due to the North Carolina Supreme Court's reliance on *Reynolds*, with its belief-action test, as being the governing law, and a state's power to regulate conduct in the interest of public welfare.[29] The *Bullard* court may have believed that *Sherbert* applies to non-criminal cases where no compelling state interest appears.[30] This approach tends to ignore the Supreme Court's general efforts during the last decade to give more recognition to individual rights, especially in the first amendment area.[31] However, despite the North Carolina court's sole reliance on *Reynolds*, further exploration will indicate that, because of particular facts, *Bullard* was decided correctly under the *Sherbert* tests.

Early recognition was accorded the states' inherent police power, subject only to constitutional limitations, to promote the health, safety and general welfare of their citizens.[32] After certain drugs, formerly praised for their pain-relieving and relaxing qualities, turned out to be habit-forming and addicting, the government and the states began to regulate them.[33] Today most states have enacted the Uniform Narcotic Drug Act[34] for the purpose of regulating and controlling the use and traffic in substances that are extremely injurious to the normal qualities and physical structure of human beings.[35] In addition, other dangerous drug acts are being passed today to regulate sedation drugs and "psychedelics."[36] Since strict laws have not

[28] *Id.* at 725, 394 P.2d at 820, 40 Cal. Rptr. at 76.

[29] 267 N.C. at 603, 148 S.E.2d at 569.

[30] *See* Brief for the State, pp. 18-19.

[31] *See generally* Konvitz, Expanding Liberties (1966).

[32] *See* Mugler v. Kansas, 123 U.S. 623 (1887). Pfeffer, Church, State and Freedom 572-603 (1953).

[33] "A narcotic is a drug which, in proper doses, relieves pain and induces profound sleep, but which, in poisonous doses, induces stupor, coma or convulsions. Narcotics tend to be habit-forming, and in many instances, repeated doses lead to addiction." State of Cal., Dep't of Justice, Bureau of Narcotic Enforcement, The Narcotic Problem 5 (3rd ed. 1964). Addiction is a state of periodic or chronic intoxication, detrimental to the individual and to society, produced by repeated consumption of a drug and characterized by an overpowering desire or need to continue taking the drug and to obtain it by any means. Schur, Narcotic Addiction in Britain and America 16 (1963).

[34] *E.g.*, Ohio Rev. Code Ann. §§ 3719.01-.99 (Page Supp. 1966).

[35] 93 A.L.R.2d 1008 (1964).

[36] *E.g.*, Cal. Health & Safety Code §§ 11901-16, New York Public Health Law §§ 3370-90. Many drugs formerly thought "safe" have later proved to be habit-forming or, because of resulting drowsiness, difficulty in thinking and uncoordinated movements, have lead to vehicular accidents, injury by falling, interference with occupational skills, and violent or assaultive behavior. Essig, "Newer Sedation Drugs that Can Cause States of Intoxication and Dependence of Barbiturate Type," 1966 A.M.A.J. 714. Certain drugs

stopped addiction and traffic in drugs, some writers advocate more liberal laws providing treatment instead of punishment, with no criminal penalties for use or possession of non-addicting drugs.[37] Yet no one denies that drug control is states' concern. The Supreme Court has repeatedly held that the right of the state to exercise its power in this area is so manifest in the interest of public health as not to be questioned,[38] and that the state has a wide range of sanctions, ranging from penal remedies to compulsory treatment.[39]

Is the state interest in drug control substantial and compelling enough to win when balanced against a constitutional claim? The words "substantial" and "compelling" have never been defined. There is no standard for adjudicating them, no scale for measuring them. In a given case, when a court talks about the state's having a substantial interest, it, in effect, has already decided that the particular interest should be upheld. Occasionally, the decision is easy, as where the purported purpose of regulation cannot be achieved and the true reason is out of favor.[40] In other cases, balancing of interests is more difficult because both sides have a good cause. Obviously, the deciding factor in such cases will be the value system of the individual judge.[41] This may result in the same subject matter being considered a substantial state interest in one case and not considered as such in another.[42]

The *Woody* court apparently read *Sherbert* as requiring a compelling state interest to enforce the questioned statute against the *particular* defendants.[43] If such interpretation of *Sherbert* is literally applied, most state

with hallucinogenic effects, such as mescaline and its salts, peyote, LSD, psilocybin, and marijuana, have become extremely popular and are termed "psychedelic," meaning "mind-manifesting," implying that they bring to the fore previously hidden or less manifest aspects of the subject's mind. They have been invested with an aura of magic, and users have described their effects in mystical terms and have sometimes claimed religious experiences. Medical evidence shows that unsupervised, nonmedical use, especially of LSD, can lead to delusions, suicide attempts, and prolonged psychoses, requiring long treatment. Cole and Katz, "The Psychotomimetic Drugs," 1964 A.M.A.J. 578, 760; Ungerleider and Fuller, "The Dangers of LSD," 1966 A.M.A.J. 389, 392.

[37] *See* Lindesmith, The Addict and the Law 283-85 (1965); Alpert and Cohen, LSD 80 (1966) (Alpert).

[38] Whipple v. Martinson, 256 U.S. 41, 45 (1921).

[39] Robinson v. California, 370 U.S. 660, 664 (1962).

[40] *See* Heilberg v. Fixa, 236 F. Supp. 405 (N.D. Cal. 1964), affd. sub nom. Lamont v. Postmaster General, 381 U.S. 301 (1965), in which the court found that detention of communist propaganda mail did not save costs; since the President favored communication with all countries, there was no basis for non-delivery.

[41] Wormuth and Mirken, "The Doctrine of Reasonable Alternative," 9 Utah L. Rev. 254, 255 (1964).

[42] *Compare* Konigsberg v. State Bar of California, 366 U.S. 36 (1961) (state's interest in regulating the legal profession considered), *with* National Ass'n for Advancement of Colored People v. Button, 371 U.S. 415 (1963).

[43] *But cf.* Zemel v. Rusk, 381 U.S. 1 (1965), which did not consider whether the particular defendant's trip to Cuba would interfere with national security.

regulations may fail, because the state may not be able to prove that exemption of the *particular* defendant will invariably produce the harm guarded against. The effect of exempting one person, or one identifiable religious group from the enforcement of a narcotics act may be negligible, yet the exemption of all those claiming use of a drug as part of their religious practices may make the state law unenforcible. Yet, if the court exempts in one case, it may feel bound to do so in another.[44]

Even if compelling state interest must be shown against a *particular* exemption, *Woody* and *Bullard* may still be distinguishable. *Woody* was decided on the basis of a particular fact situation. The court found only that the state had no substantial interest in preventing members of the Native American Church from using peyote during their religious ceremonies. Evidence had shown that peyote was used only by adult Indian males during their church ceremony which lasted from sundown to sunset. No other drugs were used, and no physical effects had been observed.[45] Since most of these facts were not presented in *Bullard*, the North Carolina court could easily have found that a compelling state interest existed against Bullard's religious immunity claim.[46]

Any adjudication regarding a claimed infringement of an individual's first amendment rights, unless the court has already found a compelling state interest in general application of the particular regulation, must involve a factual determination of the individual's sincerity of belief. It is not enough for the defendant to claim exemption on religious grounds because he is a member of a religious group which has certain beliefs requiring particular practices or abstentions. He must convince the trier of fact that he himself is sincere in his beliefs. Proof of faithful following of his church's mandates over a period of time may be convincing. On the other hand,

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[44] *See In re* Grady, 61 Cal. 2d 887, 394 P.2d 728, 39 Cal. Rptr. 912 (1964), where the court stated that its decision in *Woody* required it to grant a writ of habeas corpus to Grady to consider whether he had possessed peyote for religious purposes.

[45] 61 Cal. 2d at 720-22, 394 P.2d at 816-18, 40 Cal. Rptr. at 72-73. *See also* Constitutional Rights of the American Indian, Hearings Before the Subcommittee on Constitutional Rights of the Senate Committee on the Judiciary, 89th Cong., 1st Sess., 162-85 (1965).

[46] Most reports have dealt only with the use of peyote by Indians. Since peyote produces hallucinations, distortions of color and space perception, the drug's effects may easily result in harm to the user who is engaged in some type of activity. Also, the state has a stronger interest in controlling marijuana, which is used more widely, produces effects similar to alcohol, may create psychological dependence and is sold by narcotics peddlers. *See* Murray, "Psychology and the Drug Addict," 12 Catholic Law. 98, 108-09 (1966); State of Cal., Dep't of Justice, Bureau of Narcotic Enforcement, The Narcotic Problem 11, 12 (3rd ed. 1963); The UN World Economic & Social Council recommended that all nations destroy the cannabis (marijuana) plant and discontinue its use even in medical preparations. U.N. EcoSoc Council, Comm'n on Narcotic Drugs, Summary of Ann. Rep. of Gov'ts Relating to Opium and Other Narcotic Drugs 18 (1963).

where the defendant, as in *Bullard*, only joined his church recently,[47] and possibly after being questioned for the particular activity,[48] the trier of fact could easily find the defendant insincere. Alternatively, the trier might believe the defendant regarding peyote but disbelieve that his Neo-American Church, a peyotist religion, required the use of marijuana, a drug seldom used for religious purposes. At the same time, the trier may be influenced by his own religious and moral values and find sincerity where he believes the defendant's activities are laudable but fail to do so where they appear undesirable. In *Woody*, it was stipulated that the defendants had possession of peyote as part of their religious ceremonies.[49] Therefore, the defendants' sincerity was not an issue, as it was in *Bullard*.

Another determination which must be made in balancing state interest against a claim of religious exemption is whether a questioned regulation unduly burdens religious practices. In *Sherbert*, the Supreme Court found an undue burden; however, it failed to discuss what would be the minimum burden which would create religious exemption from a statute. The Court merely found that defendant's free exercise of religion was substantially infringed because she was forced to choose between following the precept of her religion and forfeiting benefits.[50] The finding was possibly based on a comparison with other religions, *i.e.*, if Sunday worship is important to an orthodox Christian, Saturday worship must be just as important to a Seventh-day Adventist. This process has been used before, as where the Court observed that to Jehovah's Witnesses door-to-door solicitations were just as important as a minister's sermon from the pulpit in an orthodox church.[51] Similarly the court in *Woody* first compared peyote to sacramental wine and bread, then went on to decide that for the Indians peyote was more than sacramental, it was so essential that without it they could not exercise their religion at all.[52] The California court had an easy case because the role of peyote in the Native American Church is sufficiently well known for a court to take judicial notice of its essentiality.[53] However, how can the question of essentiality be decided in other cases, where the practices are less known?

In *United States v. Ballard*,[54] the Supreme Court ruled that the verity or truth of religious doctrines or beliefs, regardless of how incredible or even preposterous, cannot be inquired into; that the only permissible inquiry relates to the claimant's honesty and good faith. This probably means that a defendant's characterization of certain religious practices as essential must be accepted. Since Bullard did not state that peyote and marijuana were

47 267 N.C. at 602, 148 S.E.2d at 568.

48 See Brief for the State, p. 17.

49 61 Cal. 2d at 717, 394 P.2d at 815, 40 Cal. Rptr. at 71.

50 374 U.S. at 404.

51 Murdock v. Pennsylvania, 319 U.S. 105 (1943).

52 61 Cal. 2d at 721, 394 P.2d at 817, 40 Cal. Rptr. at 73.

53 *See supra* note 45.

54 322 U.S. 78 (1944).

essential, must his religious claim be disregarded? Seemingly not, for the Supreme Court has never stated that a practice must be essential.[55] From the cases, it is impossible to tell when certain religious practices should or should not be accommodated.[56] Also, even if a court would like to see some practices accommodated, if they are uncommon and have no analogy in the jurors' own religion, the jury may frustrate the court's attempt by finding the defendant insincere in his beliefs.

Relevant also to the question of religious freedom is the issue of whether one may claim a constitutional exemption from state regulation grounded on personal, as distinct from institutional religion. Inasmuch as Bullard had joined his church only recently, a fact which might influence the jury against finding that he was following the dictates of his church, could he have fared better by claiming that the drugs were necessary for the practices of his personal religion? Obviously a personal religion may be more meaningful, more intense than an institutional religion because the individual does not follow rituals set by others but searches for original experiences.[57] The first amendment is read today as securing all forms of religious expression, creedal, sectarian or nonsectarian, wherever and however taking place,[58] but, it must be established first that a religion is involved. The Supreme Court has expanded the concept of religion to include nontheistic religions such as Ethical Culture and Secular Humanism.[59] A belief in a Supreme Being is no longer necessary, and may be replaced by a sincere and meaningful belief which occupies in the life of its possessor a place parallel to that filled by God in the life of others.[60] Some courts have read this broadly and found religion even where they could not tell what it was.[61] However, a definition of religion would not, in itself, solve the problem, for sincerity of religious belief must still be established. Seemingly, sincerity of belief in personally acquired precepts would be more difficult to prove than belief in precepts recognized by some group, however small, because extrinsic standards of behavior would not exist as a basis for judging one's sincerity.

In conclusion, the foregoing indicates that even if *Bullard* had been reversed to consider whether or not any burden was placed on the defendant's

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[55] Apparently the California court was simply trying to find some rationale for distinguishing *Reynolds*. It did not succeed, because, if a Mormon is condemned to eternal damnation for not practicing polygamy (98 U.S. at 161), how can polygamy be non-essential?

[56] Kurland characterizes the current events in the religious area as "accommodation," without any guidelines as to how much tolerance there should be. Kurland, "Foreword —Church and State in the United States: A New Era of Good Feelings," 1966 Wis. L. Rev. 215.

[57] James, The Varieties of Religious Experience 24-41 (First Collier Books ed. 1961).

[58] Everson v. Board of Education, 330 U.S. 1, 32 (1947) (dissenting opinion).

[59] Torcaso v. Watkins, 367 U.S. 488 (1961).

[60] United States v. Seeger, 380 U.S. 163, 166 (1965).

[61] *See* United States v. Stolberg, 346 F.2d 363 (7th Cir. 1965).

free exercise of religion and whether any compelling state interest outweighed such infringement of first amendment rights, the final outcome might still have been the same. The Minnesota Supreme Court has well summarized some of the problems in this area:

> What constitutes "religion," and whether the free exercise of conscience is also entitled to protection, are questions yet to be decided by the United States Supreme Court. Nor are we able to suggest future guidelines for ascertaining in particular cases whether or not the First Amendment is being invoked with sincerity.[62]

[62] *In re* Jenison, 267 Minn. 136, 137, 125 N.W.2d 588, 589 (1963).